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Integrating Strategic and Financial Planning in Turbulent Times

By Cathy Sullivan-Clark and Dennis Kennedy

At a Glance

- **Develop robust baseline financial projections using sensitivity analyses.**
- **Identify and communicate the profitability of key services and programs.**
- **Be ready to answer questions or develop analyses quickly to address emerging strategic issues.**
- **Help others to move forward strategically despite economic turbulence.**

In good times and bad, the goal of integrating strategic and financial planning in health care remains constant: to align strategic priorities with the allocation of available resources to ensure that the organization remains able to fulfill its mission in the long term. In theory, the same is true of the planning process itself and the role of the CFO in planning. However, in reality, many aspects of the process and the CFO's role fundamentally change in turbulent economic times like these.

Fortunately, there are concrete steps that savvy financial leaders can take to avoid common pitfalls and to both prepare for and contribute to integrated planning in the midst of even the most trying economic conditions.

The Planning Process

During an integrated planning process, strategic and financial planning take place along parallel tracks but intersect at key junctures (see the exhibit on page II). The environmental assessment conducted in strategic planning should inform the development of baseline utilization and financial projections. Assessment of financial capability—estimation of current and future sources of funds—flows out of the financial projections and helps frame strategic discussions. Sound evaluation criteria for the assessment and ranking of potential tactics include both strategic and financial criteria. Last but not least, one of the final steps in the process should be the development of volume and financial forecasts that reflect the likely impact of successful strategic plan implementation.

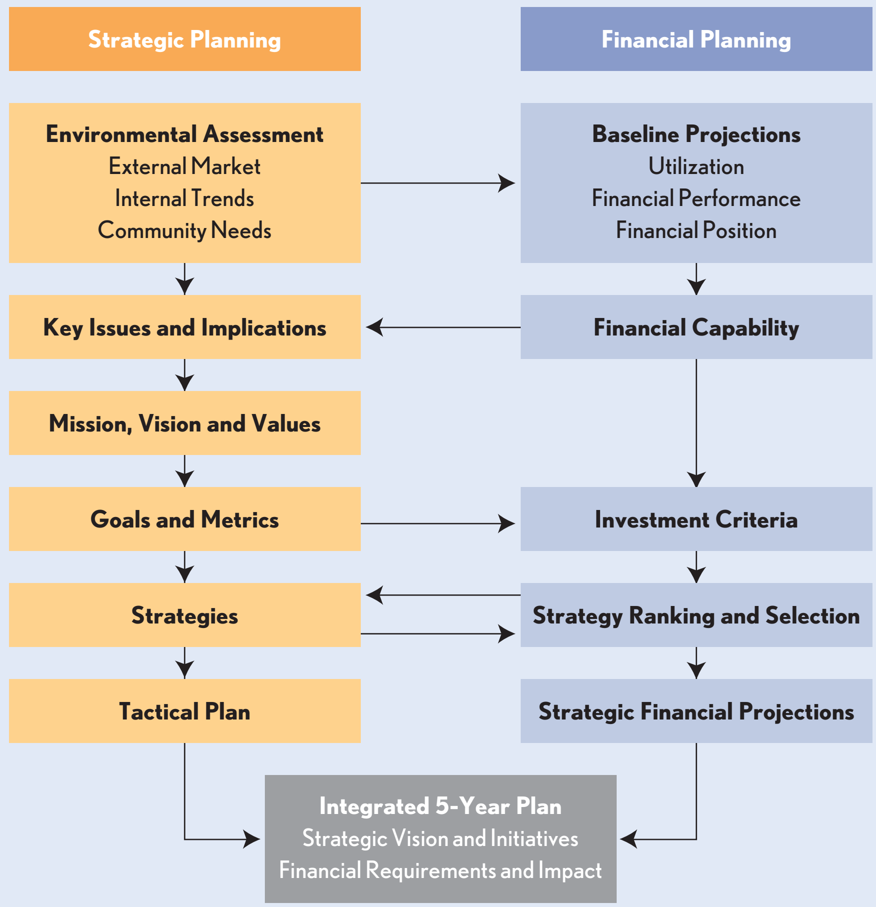
In ordinary times, healthcare organizations do not apply much rigor to the financial side of the planning equation. Even those organizations that do develop associated financial plans are somewhat casual in their approach; baseline financial projections tend to be rather straightforward and represent a simple continuation of recent history or trends. Financial capability assessments generally focus on how much incremental debt, if any, the organization can incur. Evaluation criteria (including financial criteria) are usually very broad, and while their use may illuminate service strengths and/or potential program opportunities for development, they do not foster comprehensive portfolio management, including cutting or redesigning underperforming assets.

Finally, new goals and strategies tend to be layered on existing results, leading to financial projections that are additive in nature. That is, the usual planning process says "yes" to a number of new initiatives without the difficult step of discontinuing any existing priorities.

Economic upheaval requires more robust financial planning and an increased focus on the critical intersections between strategic and financial planning. Here are some examples:

> Baseline financial assumptions and the resulting multiyear projections are much more challenging to develop and require substantially more iterations. Accordingly, organization leaders must become more adept at dealing with and helping others to deal with financial uncertainty.
> The assessment of baseline financial capability becomes even more important

An Integrated Strategic and Financial Planning Process



Source: Noblis Center for Health Innovation. Used with permission.

as an initial planning step to frame likely shortfalls or highlight potential problems (e.g., inability to meet debt covenants).

> Because there is less capital to spend and mistakes are harder to recover from, linking capital allocation to strategic priorities becomes a necessity rather than a nicety. Thus, financial criteria gain more weight against other criteria in the investment evaluation process.
> Real portfolio management—truly addressing "losers"—becomes an imperative for many organizations.

The Role of the CFO

Ideally, the CFO is an active participant in the integrated strategic and financial planning process, particularly at those junctures where the two disciplines intersect. If the goal is to ensure long-term financial viability to serve mission, it follows that the key executive responsible for financial performance must play a key role. Because they typically are inquiring, thoughtful, empirical, and accustomed to balancing opportunities and risks, most CFOs are well-suited to do so.

In more relaxed circumstances, however, CFOs generally defer to the board, CEO, or chief planning officer who lead in shaping the vision and strategic priorities. CFO involvement tends to be limited to analyzing potential strategies or giving input regarding financial assumptions or trends. Worse, the CFO may simply be invited in to say "no" when others in the organization cannot make up their minds. The result is that financial planning is largely undertaken after the strategic planning process and is focused on trying to pay for the plan after the fact.

But in times of great economic stress, the CFO can and should assume more prominence during strategic planning. Many organizations become paralyzed by worsening economic conditions and expectations and are tempted to put strategy aside, focusing instead on crisis management or short-term survival. The CFO can be the voice of reason here, calling for and championing prudent strategic investments.

Specifically, financial leaders can:

> Highlight the magnitude of change needed to respond to current economic pressures
> Help others understand the types of strategic responses likely to be most successful
> Build a sense of urgency within the organization for moving forward—prudently but decisively—in the face of uncertainty

Organizations that decide to simply wait things out may find themselves too far behind to catch up once conditions improve.

Common Pitfalls—and Solutions

Integrating strategic and financial planning is challenging enough in good times. In times like these, both the imperative for and degree of difficulty associated with integrated planning increase. Here are some typical traps to avoid.

Constantly revisiting assumptions/baseline projections. While updating budgets and projections to accord with the latest results is, of course, prudent, holding up strategic planning for constant adjustments to short-term conditions is counterproductive. A better way to address short-term changes is to combine a baseline projection with multiple sensitivities/scenarios that encompass a range of possible futures. Through this exercise, CFOs may well find that short-term conditions will not drastically alter long-range expectations.

Setting the CFO up as the bad cop. Hard times will not deter people with pet projects, who will continue to press for investment and financial support. Indeed, their claims may increase in parallel with the difficulty of making the numbers work. For example, project proponents may forecast greatly improved volumes without any substantial increases in salary expenses. This puts the CFO in the position of final arbiter (if he or she isn't already).

One approach to counteract this is to use standardized investment criteria and ranking methodologies that allow for apples-to-apples comparisons of competing projects. This often encourages more reasonable projections/claims from project partisans while enhancing their accountability for achieving results. It also helps the CFO articulate the conditions required for the organization to give the project a green light.

Being too conservative. The tendency during normal times is to develop baseline projections that "creep" forward based on previous trends, which, in general, inch slightly but steadily upward. In turbulent times, many organizations fall into the opposite trap, projecting steadily decreasing performance based on short-term blips. The impact of this trend on planning discussions is profound, as overall financial capability to support strategic investment becomes either nonexistent or severely diminished.

Unrelieved gloom and doom is as irrational under the circumstances as cockeyed optimism. If they are to maintain sound judgment, organization leaders must be able to take current pressures with a grain of salt. The fact is that health care as a whole generally rebounds, and no organization will allow its financial performance to dramatically deteriorate without taking every step at its disposal to reverse the negative trend. Strategic financial forecasts must be appropriately balanced to reflect this reality, encompassing current difficulties as well as corrective strategies.

Stepping up to the Plate

In the current economic environment, financial leaders who want to play an essential role in preparing for and contributing to a successful integrated strategic and financial planning process should take the following steps:

> Insist on robust baseline financial projections that deal with uncertainty through the development of sensitivity analyses.

> Understand the underlying profitability of key services and programs and communicate this information simply and clearly to others.

> Keep decision-support tools and staff in a state of readiness, able to answer questions or develop analyses quickly to address emerging strategic issues.

> Be willing to put on a "strategy" hat as needed and help others to move forward strategically despite today's financial turbulence.

Too often, strategic planning is a low priority in tough times—exactly when it's needed most. Now is the time for healthcare organizations to renew their commitment to a strong integration of strategic and financial planning. By helping their hospitals understand and act responsibly on this reality, financial executives can help ensure that they emerge in good shape at the other end.

Cathy Sullivan-Clark is senior principal, Noblis Center for Health Innovation, West Springfield, Mass. (cathy.sullivan-clark@noblis.org). Dennis Kennedy is principal, Noblis Center for Health Innovation (dennis.kennedy@noblis.org).