How Refining Your Organization’s Approach to Treasury and Capital Markets Can Yield Strategic Value

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Every healthcare organization has a portfolio of financial risks and resources which its leaders seek to deploy in a manner that balances the pursuit of growth against a set of guardrails that ensure financial health. Sustainable growth requires the prudent allocation of key financial resources, such as cash, credit, leverage, and invested assets. This process represents Treasury work and is the cornerstone of the organization’s ability to assume appropriate risk in the pursuit of growth. Done well, Treasury can provide significant value to the overall organization.

**Treasury Functions in Healthcare**

Healthcare organizations approach Treasury functions in different ways. Many health systems use a dedicated Treasury model and have a Treasurer, who manages liquidity as well as non-operating assets and liabilities. Many more organizations distribute core Treasury functions across multiple executives, perhaps with a Controller handling cash, and the Chief Financial Officer handling credit, debt, and investments. Each organization confronts different facts and circumstances, but the decision on Treasury structure typically focuses on cost and complexity.

Kaufman Hall can help your leadership team define the right approach for each of the four core Treasury areas described next: capital management, Treasury operations, external financing, and invested assets (Figure 1). Future articles in this series will address each area in more detail, and describe how to integrate these components within a strategic Treasury framework.

**Figure 1. Four Core Treasury Functions**

*Source: Kaufman, Hall & Associates, LLC*
**Function 1: Capital Management**

Capital management activities focus on identifying, managing, and allocating capital and credit resources in order to stay within the “financial health corridor of control” (Figure 2). This corridor represents the equilibrium between strategic investment and financial capability. If an organization falls above the corridor of control in the area labeled “over investment,” its financial need or strategic capital appetite exceeds its financial capability.

*Figure 2. Financial Health Corridor of Control: Balancing Strategy and Financial Capability*

Source: Kaufman, Hall & Associates, LLC

Within the capital management function, credit positioning and monitoring ensure that the health system achieves and maintains a credit rating that can support access to the required amounts of affordable external capital. Rating and creditor coordination ensure timely and detailed communication of both negative and positive deviations from budgets and near-term forecasts.

The definition of capital capacity (both debt capacity and excess cash) determines the amount of capital—obtained through internal operations and external sources—that the organization can reasonably be sure to generate to support its development over a defined period of time. Capital resource allocation deploys scarce capital resources (cash and debt capacity) to the mix of strategies or initiatives that will enable the organization to achieve the best-possible market strength and differentiation, and sustainable competitive financial performance.

All of this is defined by a set of financial targets/ratios that represent the organization’s particular definition of its financial health corridor of control.

**Function 2: Treasury Operations**

Treasury operations focus on managing organizational liquidity, as well as building the infrastructure to support the seamless flow of credit/capital across the organization.

The core of this function is cash management and the maintenance of commercial banking accounts and products that facilitate receipt and payment of cash. Best practices include conducting periodic reviews of banking relationships to ensure that the organization uses the most innovative product offerings, and to the extent possible, aligns ancillary services across credit and non-credit banks. Specific areas that can provide value to the organization are streamlining the payment posting process in the revenue cycle, and maximizing terms discounts and rebates through accounts payable and the supply chain.
In addition to liquidity management, the operating Treasury chassis looks to facilitate the free flow of credit and capital to wherever it is needed to defend operations or support growth initiatives. This might include a foundational master trust indenture, and should incorporate centralized control over all Treasury activities across the organization, including with merging entities.

**Function 3: External Financing**

Activities related to external financing focus on building and maintaining an appropriate portfolio of comprehensive debt instruments.

This function controls access to outside funding, including markets, products, and relationships. Decision-support techniques and tools should focus on optimizing portfolio composition against risk objectives. An organizational point of view is established across funding channels (debt and leasing), funding partners, and financing products, including swaps and floating-rate instruments.

The financing portfolio is managed continuously across core—i.e., debt and swap—and comprehensive funding activities, including leasing and pension. Organizations are supported by relationships with external financing experts, such as financial advisory firms and investment banks.

**Function 4: Invested Assets**

Activities in the invested asset area focus on building and managing an invested asset chassis that drives return while remaining within appropriate risk parameters codified under the organization's Investment Policy statement. Articulating a clear role for cash investment and its responsibilities to the operation is paramount for establishing appropriate expectations and guardrails.

Many organizations establish relationships with investment advisors and some are beginning to transition discretionary responsibilities to external parties through an Outsourced Chief Investment Officer model.

**A Changing Operating and Treasury Environment**

In many organizations, Treasury activities—and balance sheet resources—are built and managed with only an indirect relationship to operations and strategy. Of course, capital capacity and external capital access are integrated into the planning process, but debt and investment portfolios often are built in relative isolation. In times of business model stability, this fragmented management of the Treasury functions can be tolerated. Each area can make its unique best contribution with less pressure on how each component works (or doesn't work) relative to the others.

Problems arise now that healthcare has entered into what likely will be a sustained period of financial volatility and increasingly scarce resources. Market forces, healthcare costs, payment reform, and strategic investment requirements are forcing a business model change that is challenging the strategic, operational, and capital/credit position of most hospitals and health systems. Volatility within the investment and debt markets may create equal challenges related to the construction and management of portfolios of financial assets and liabilities.

These disruptive forces are challenging the definition of financial health; but they also are forcing a shift in the appropriate focus of the corridor of control from financial health as illustrated in Figure 2 to the balancing of risk against the resources available to offset or carry risk, as illustrated in Figure 3.
The imperative for today’s healthcare organizations is establishing a framework that integrates Treasury, operations, and strategy more tightly than ever before. If the prior model was Integrated Strategic and Financial Planning, the new model must be Integrated Strategic, Financial, and Treasury Planning. Treasury’s inclusion ensures that the management of operations, capital, liabilities, and invested assets is captured under a single decision-support and resource-allocation framework.

As depicted in Figure 4, resource allocation functions performed by Treasury sit at the center—bringing together the credit and financial resources of the organization with a new focus on staying within the enterprise risk corridor of control.
Where to Go From Here

Healthcare leaders can examine the Treasury functions that are in play in their organizations, and shore up the weak points. Kaufman Hall can help in this regard. We also can help to develop the Treasury and Capital Markets approach that can integrate Treasury, strategy, and operations, and can help the organization migrate from business line to enterprise-oriented financial risk and resource allocation (see Sidebar).

A truly integrated Treasury and Capital Markets approach offers the opportunity for hospitals and health systems to prioritize a number of competing factors. For example, if a health system is carrying excessive risk on the operational side due to heavy investments in population health or other initiatives, it may be prudent to minimize the risks embedded in its debt or investment portfolios. Alternatively, if a health system has minimal liability-side exposure, the system may be positioned to leverage greater risk in its operations or in its investment portfolio to drive increased returns. Every organization experiences tension between pursuit of strategic initiatives and pursuit of investment returns, but an integrated approach offers a differentiated level of decision support that can lead to a more informed allocation of resources against the realities of the prevailing business and risk environment.

Healthcare leadership teams can use the Treasury and Capital Markets approach to drive decision making about how best to prioritize and deploy resources. The result is a balancing of resources and risks across operations, strategy, capital spending, invested assets, and liabilities that is more responsive to the current complex business/operating environment. This enhanced resource deployment defends the health system from outsized claims on liquidity while better supporting the pursuit of risk-adjusted returns.

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Supporting Resource Deployment in a Risk-Adjusted Enterprise

A multihospital not-for-profit health system has engaged Kaufman Hall to define and establish a Treasury platform that will support the effective deployment of resources in a challenging business environment. Working closely with the System’s leadership team, Kaufman Hall is conducting a four-phase process, including:

- **Defining a Treasury platform:** The definition is based on a thorough assessment of the organization’s Treasury functions, and consideration of whether the System needs or wants to build out functionality that is not in place, relocate functions that are being delivered under a particular department or area, and insource/outsource certain activities, such as investments. The result is a recommendation of how to structure, staff, and govern Treasury.

- **Organizing an Investment Advisor selection process:** Given the change in direction, a selection process was conducted to define the investment support framework, developing a request for proposal (RFP), reviewing RFPs, scoring for advisor selection, and negotiating with the selected advisor.

- **Establishing an integrated enterprise resource allocation framework:** This phase involves creating a comprehensive risk map or catalog, and analysis of how those risks translate into claims on liquidity. Assessment of risk resources and corporate risk tolerance enables development of a recommended risk-adjusted investment portfolio.

- **Integrating the investment advisor and operationalizing the resource framework:** This phase involves integrating the resource framework into the ongoing asset allocation and tracking process, and establishing a process for updating key components of risk analysis.

Source: Kaufman, Hall & Associates, LLC