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can a hospital benefit from partnering with physicians?

Hospitals and physicians have a tremendous opportunity, today, to collaborate on and reap the rewards of an ASC joint venture.

AT A GLANCE

> The prospect of accountable care organizations gives hospitals good reason today to consider the benefits of developing an ambulatory surgery center (ASC) as a joint venture with physicians, as well as the risks of not pursuing such a strategy.

> A key potential benefit that such an ASC can offer a hospital is the ability to enhance a hospital's physician recruitment efforts and increase surgical volume.

> Another important consideration is whether the hospital and physicians possess the collective expertise, performance track record, capital, tenacity, perseverance, resources, and credibility to perform the necessary functions of the ASC on their own.

How will proposed healthcare reform measures affect the relationships between hospitals and their medical staffs? How can hospital executives develop tangible programs that will enhance those relationships?

Hospital finance leaders face many challenges in today's uncertain healthcare environment, but working effectively with physicians ranks among the most important—and most difficult. Many hospital executives are rightly concerned about the potential loss of key physicians. This attrition can be due to various factors, but one of the leading causes is the activity of competitors—and not just other hospitals, but also the physicians themselves.

Entrepreneurial physicians have shifted, and will continue to shift, surgical volume and diagnostic testing away from hospitals—their traditional target venues for such referrals—to other venues in which they have a financial stake. The growth of ambulatory surgery centers (ASCs) continues to pose challenges for hospitals, specifically in those instances where a hospital does not have a financial interest. As hospitals consider the relative merits of developing integrated delivery models such as accountable care organizations (ACOs), and even of employing more physicians, some may be losing sight of viable opportunities to partner with physicians in jointly owned ASCs.

Pursuing such a joint venture can help a hospital offset the effects of today's tenuous economic conditions and proposed healthcare reform initiatives, which

For a list of questions that hospitals should ask when evaluating an ASC development and management company as a potential corporate partner to a joint venture ASC, go to www.hfma.org/hfm.

will not only exacerbate the downward trend in payment from governmental insurers, but also undermine hospitals' ability to compensate for payment reductions by increasing charges to private patients and commercial insurers.

Physicians also have good reason to be receptive to partnering with hospitals. Clearly, the combined concerns of physician payment reform and different forms of bundled payments are prompting many physicians in private practice to question the extent that they will continue to be able to control their own financial destiny. Depending on the steps a hospital's leaders take to position the organization, physicians are likely to view the hospital as part of either the problem or the solution.

Joint Venture ASCs: Benefits and Risks

Before embarking on a strategy to develop a joint venture ASC, both physicians and hospitals will need to consider thoroughly the potential benefits and risks. These considerations should include an assessment of the relative merits of developing an ASC as a joint venture compared with going it alone.

Considerations for physicians. The ASC model has long been attractive to physicians. It can provide a significant income stream at a time when they are facing declining payments. However, for many physicians, nonfinancial factors are equally important. These factors include:

> Physician control over the surgical schedule, staffing, and equipment used at the ASC
> A surgical schedule free of disruption by emergency cases
> Operating rooms (ORs) that are turned around in less than 10 minutes
> Increased convenience for both physicians and their patients

Physicians are likely to find an ASC attractive as a venue that is not burdened with the bureaucracy often found within a hospital, regardless how efficiently the hospital might operate. An ASC also offers physicians a less risky setting for procedures than an office-based procedure room, and it provides physicians with greater opportunities for efficiencies and access to a broader array of equipment and staff, both clinical and nonclinical.

A hospital involved in an ASC in which it has equity has the option of shifting some ambulatory surgical volume to the ASC, thereby increasing capacity for higher acuity inpatient cases in its main ORs.

Questions that inevitably arise from physicians revolve around the perceived value or lack of value in partnering with a hospital. Physicians will be motivated to collaborate with hospitals on an ASC for the following reasons:

> Improved access to capital
> Accelerated timeframe for ASC completion
> Opportunities related to regulatory hurdles, particularly in those states requiring certificates of need, where partnering with a hospital may be required
> Tangible ROI
> The hospital's ability to assist with procurement of supplies and equipment
> Improved productivity, throughput, and efficiency
> Ability to maintain a relationship with the hospital
> Opportunity to gain enhanced payment rates using the hospital's existing relationship with payers

Hospital considerations. Hospitals likewise have many compelling reasons to consider a joint venture ASC with physicians. Potential benefits to hospitals include:

> An increase over current volume
> Ability to grow market share
> Enhanced relationships with surgeons
> Opportunity for a new revenue source
> Strategic positioning, as part of both an offensive and a defensive strategy

> Improved physician recruitment and retention
> Improved patient satisfaction

Such joint ventures may also raise some concerns for hospitals, however, including the potential for cannibalization, as patients are drawn to the ASC who otherwise might have visited the hospital.

Ultimately, hospital executives will need to base their decision of whether to pursue a joint venture ASC strategy on a thorough consideration of the potential risks and rewards associated with the strategy. Many hospital executives focus exclusively on the traditional risk factors of an ASC investment. They have historically viewed ASCs as threats to their ambulatory surgery business, which many regard as essential for the growth in their inpatient surgical volume. They are concerned whether the hospital will be able to backfill the OR time freed up from the reduction in ambulatory cases.

They also may be concerned about whether the ASC will be profitable. Achieving better than break-even performance poses a significant challenge for ASCs across the nation, given many potential impediments to financial success they face. Factors that can undermine an ASC's financial performance include lack of sufficient case volume, over-built facilities, inadequate payer contracts, and poor management.

The fact is, however, that fewer than one out of every four ASCs are partnered with hospitals, in part due to concerns about the risk factors previously cited and in part due to the general reluctance of some hospital executives to consider such an initiative unless the hospital owns, controls, and manages a controlling interest in the venture.

But hospital executives should consider other risk factors, as well. For example, what if a competitor uses an ASC to lure the hospital's physicians away? What if the hospital's physicians leave to develop an ASC on their own? Some hospital executives now perceive that a missed opportunity for such a venture could precipitate a severe reduction in a hospital's surgical volume by disenfranchising busy and productive surgeons and polarizing the medical staff. They see joint venturing with physicians as a means to preserve their surgical volume, attract new physicians, retain productive physicians, and grow market share and geographic penetration.

Simply put, a proactive strategy involving a physician-owned surgery center can be tremendously rewarding for a hospital. Establishing an ASC can enable a hospital to reduce its overhead while regaining space for new and existing services and procedures. And it can improve patient satisfaction, as patients prefer the easy accessibility of an ASC to the challenges of navigating a traditional complex hospital setting.

Moreover, the risk of inaction can far outweigh any other risks. By not acting, a hospital may create a tremendous opportunity for its competitors. Recall that, facing payment reductions, many physicians are actively seeking alternate ways to maintain their income. A hospital's decision to pursue an ASC strategy after its competitor makes the first move runs the risk of incurring physician resentment for being "too little, too late."

Even so, a joint venture ASC may not be the best strategy for all hospitals. Those most likely to benefit from such a strategy share certain characteristics:
> ORs at or near capacity
> A pressing need for additional revenue sources
> An interest in recruiting surgeons away from competitors (both hospitals and other ASCs in which the physicians may not have equity positions)
> An interest in retaining high-value surgeons
> A desire to increase market share
> A strategic focus on expanding the hospital's service areas
> Ownership of an existing ASC that is underperforming financially or operating significantly below its potential

Shared considerations. Hospitals and physicians may each agonize over the potential of losing total control and even sharing the profits, but these concerns are relatively inconsequential when compared with the financial, operational, clinical, productivity, and marketing advantages both parties gain through the partnership. Further, partnering allows for shared risk and collaborative decision making that helps ensure clinical and managerial decisions affecting the ASC's overall performance receive due consideration. Effective collaboration also can strengthen physician recruiting efforts; enhance purchasing, managed care, and real estate negotiations; shorten the timeframe for launching the venture; and make it easier to address regulatory challenges in those states where CON requirements exist.

A Strategy to Increase Surgical Volume

Of all the benefits that a joint venture ASC can bring to a hospital, the ability of such an ASC to enhance a hospital's physician recruitment efforts and increase surgical volume warrants particular attention. The ASC can be attractive to surgeons with established practices in the area who may be splitting their surgical time among different hospitals. It stands to reason that surgeons who want to reduce travel time and maximize productivity are likely to bring the majority of their inpatient surgical volume to the same hospital to which they bring the majority of their ambulatory surgical volume.

Hospitals may also find that the geographic location of the ASC will have significant influence in capturing market share. For example, locating the ASC in a new service area for the hospital can give the hospital access to new patients who find the new location more convenient—and to new surgeons who may have either their primary or satellite offices in that service area.

Hospitals should also not underestimate the branding and visibility opportunities generated through a joint venture ASC. A positive experience encountered by both the patient and surgeon in a "branded" ASC jointly owned by the hospital and physicians will have residual benefit as both entities will form or reinforce positive perceptions about the hospital.

A major concern for hospitals is managing the overall surgical scheduling process, which includes effectively allocating block time to surgeons. The crux of the challenge is in knowing how to allocate time judiciously to provide maximum time to productive physicians representing a wide range of specialties, varied patient acuity, and differing needs in terms of equipment, nursing, and anesthesia support.

By participating in an ASC, the hospital can generally improve internal performance of the ORs and peri-operative and postoperative services. A hospital involved in an ASC in which it has equity has the option of shifting some ambulatory surgical volume to the ASC, thereby increasing capacity for higher acuity inpatient cases in its main ORs. By "backfilling" the now available operating capacity with inpatient surgery, the hospital enhances its profitability primarily due to the inpatient contribution margin, which can be significantly greater than the outpatient contribution margin for procedures in the same surgical specialty.

In addition to freeing up capacity, a joint venture ASC can provide a hospital with an additional revenue stream based on its equity position. If a hospital is not at capacity in its ORs, it should estimate the potential surgical volumes of physicians who it plans to recruit to the ASC and the inpatient cases that some of these physicians might bring to the hospital. These inpatient cases, which are frequently more lucrative to the hospital, may offset the declining revenue of ambulatory cases migrating to the ASC.

Perceived Obstacles to a Joint Venture

Objections to a joint venture ASC that physicians or a hospital may raise should be treated as merely starting points for discussion. The inability to address and counter these objections eventually to both parties' satisfaction ultimately will call into question the structure and value of the entity to either the hospital or surgeons. Typical objections that may surface include:

> Inherent distrust of hospitals by the physicians

> Failure to see value in exchange for granting a percentage of ownership

> Hospital perception that joint ventures will encourage more independent activity by physicians
> Possible negative reaction of some physicians who will not be able to participate in the joint venture (given their surgical specialty or safe harbor compliance)
> Reticence of either party to relinquish total control over the venture

Feasibility Considerations

Physicians who view ownership as merely a vehicle to gain financial rewards through the work of their colleagues are probably not solid candidates to be investors. Hospitals that are unwilling to allow physician investors to oversee clinical and operational aspects of the day-to-day activities of the ASC are equally dubious partners. The financial pro forma needs to be realistic and yield an ROI that is acceptable to the parties. A committed group of busy and productive physicians (multispecialty) who have the requisite skills and demeanor enabling them to be successful in an ASC environment is essential.

The feasibility analysis should also substantiate that there is adequate market share to be gained for the venture to be profitable and for risk to be diversified. Revenue numbers that overstate potential volume or revenue per case will not only make the projections invalid but also undermine the basis for success and reinforce any cynicism that the parties may harbor about the viability of the deal. In essence, all parties require a level of trust and respect for each other if there is a reasonable expectation to succeed. There should also be contractual language that precludes competitive investments by the parties that could have an adverse impact on the proposed deal. Finally, estimated construction, start-up, and turnaround costs should reflect reasonable and competitive rates.

Keys to Success

Hospitals and physicians developing a joint venture ASC will have multiple questions throughout the process. Just a few examples include:

> How is state licensure and Medicare certification obtained?
> Who will negotiate managed care contracts, and when?
> Where will the financing come from to establish or acquire an ASC?
> Who should identify the location and handle the real estate negotiations?
> How long will it take to secure the necessary regulatory approvals and to make the ASC operational?
> What is the optimal ownership and governance structure?
> Who should handle physician recruitment, and what selection criteria should be used?
> Who should manage the syndication process?
> Who should manage the entire operation, and is it beneficial to partner with an ASC development and management company?

Answering these and other questions requires serious introspection from both parties as to whether they have the collective expertise, performance track record, capital, tenacity, perseverance, resources, and credibility to perform the necessary functions on their own. Often, they do not, nor do they have the time and ability to focus

How Best to Structure the Deal

A joint venture ASC can be structured in a variety of ways. However, a particular model that has been widely successful and that the parties tend to regard as being equitable has an ownership structure that is 50 percent physicians, 25 percent hospital, and 25 percent corporate partner.

Many hospital executives are troubled by the thought of affording the largest share of ownership in the ASC to the physicians. This model is effective, however, because the physicians feel that it is "their" surgery center. With this mindset, physicians are more likely to play an active role in many aspects of the business, including recruiting other surgeons. Surgeon partners will be more inclined to recruit colleagues from competing institutions and other ASCs in which the physicians do not have equity if they perceive that doing so is in their financial best interest. Physicians with a majority share of ownership also tend to be more receptive to discuss matters such as case costing (microanalysis of all resources used per given case), supply utilization, surgical schedule compression, and on-time arrival for their cases. For this reason, physician partnerships can promote efficiencies that are extremely difficult, if not impossible, to replicate in the hospital environment.

on all aspects necessary to develop or acquire an ASC, given other priorities and need to be diligent in managing hospital operations or the physician practices. In such instances, they should consider a three-way partnership that also draws on the expertise of an ASC development and management company.

Benefits of a Corporate Partner

An ASC development and management company with a successful track record and ample experience with the clinical, operational, financial, and quality aspects of developing an ASC can be a valuable partner in ensuring the success of a joint venture ASC. Such a corporate partner will understand—probably much better than the hospital—how to recruit surgeons, oversee architectural planning, develop pro formas, create operating agreements, and manage the center effectively on an ongoing basis. Equally as important, the firm will know the potential pitfalls, so it can help the hospital avoid mistakes in the development process that could not only undermine the venture's financial prospects, but also damage the hospital's relationship with its surgeon partners.

A corporate partner also can be a great asset to the hospital in maintaining relationships with its surgeons. It is likely that most surgeons will want to be part of the new ASC. Given that it will be a for-profit initiative, not every physician will be a good fit for the ASC. A corporate partner can help identify specialties that are likely to be profitable and those that should be avoided. It also can work with individual physicians to determine whether their surgical practice and personalities are well suited for the ASC.

In some instances, physicians who are valuable to the hospital may not be so well suited to an ASC environment. For example, an acute care hospital is a more appropriate venue than an ASC for a surgeon who performs complex cases requiring the full range of services that only the hospital can deliver (e.g., total joint replacement procedures. A corporate partner can help the hospital maintain its relationships with these physicians by remaining neutral during the selection process.

A loss of momentum or deal fatigue is an inevitable result if the hospital and physician partners lack the expertise or desire to handle ASC development on their own. An experienced ASC development and management company can keep the group moving forward by helping to access needed capital and overseeing the complexities of building, staffing, equipping, and operating a successful ASC. Inevitably, when obstacles or unexpected challenges threaten to delay or derail the project, the corporate partner should be able to bring perspective, context, and sufficient resources to resolve the issues satisfactorily.

Sufficient case volume that is also profitable is a prerequisite to an ASC's success, but building this volume will require significant effort and time for physician recruitment, and the ASC development and management company should be adept in this area. But it is not enough for the corporate partner to manage this development and acquisition process alone. Ideally, the hospital and an appropriate nucleus of surgeons identified at the outset should take an active role in collaborating with the company on all physician recruitment activities.

The foregoing are just a few of the areas in which a corporate partner can play a pivotal role. Other areas in which the company should demonstrate excellence include:

> Managing day-to-day operations and helping the venture stay focused on achieving clinical excellence, operational efficiency, and profitablity
> Benchmarking with other ASCs in its portfolio to improve efficiencies
> Understanding how to build to proper size and scope and avoid overbuilding
> Being able to serve as an effective mediator and objective party should contentious issues arise

(For a list of important questions to consider when evaluating the suitability of such a partner, go to www.hfma.org/hfm.)

Effective Positioning for the Future

Healthcare reform legislation should prompt hospitals and physicians to seriously consider partnering to develop or acquire ASCs. With the industry embracing the concept of ACOs, hospitals and physicians have incentives to identify opportunities to collaborate on developing efficient care processes. ACOs will receive a global fee for providing service to patients and then disburse funds to the appropriate providers. The payments will include incentives if care is rendered at lower costs.

Even though the Medicare program pays ASCs, on average, approximately 60 percent of what it pays hospitals for the same procedures, ASCs will continue to grow if developed and managed effectively because of their ability to provide high-quality and efficient care at a lower cost than in the hospital setting. Hospitals and physicians should seize the opportunity to capitalize on these advantages of ASCs by partnering in ASC development. ●

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