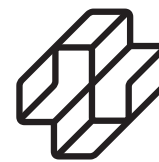


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Physician Employment: A Win for Providers and Physicians

By Craig E. Holm, Kathleen H. McCarthy, and Paul C. Brucker, Jr.

Physician employment arrangements can be structured to benefit providers and physicians, both financially and strategically.

Physician employment is reemerging as a must-have strategy for many hospitals and healthcare systems as they continue to face declining reimbursement, intense competition for physician services, and difficulties securing adequate call coverage. Employment arrangements can be financially and strategically beneficial for both healthcare providers and their physician employees—provided they are carefully structured to benefit and satisfy both parties.

Physician employment often enables healthcare organizations to secure call coverage, successfully recruit physicians who don't want the burden of managing a practice, and stave off initiatives from physician practices that opt to aggressively compete with hospitals. For physicians, employment can provide a stable and secure level of compensation not

available in some private or group practice environments.

An Evolving Strategy

Physician employment has a checkered past that peaked in the early 1990s. It initially had the feeling of a fad, with impulsive organizations ready to try the latest trend—assuming that their expertise in managing a hospital or system would easily translate into running an efficient and financially viable practice. Many hospitals and systems also felt compelled to employ physicians since it was viewed as a necessary and essential component of integrated delivery systems.

However, minimal forethought was given to the costly start-up expense of these employed physicians or practices and the unique practice infrastructures. Little or no consistency or administrative

oversight existed to maintain acceptable accounts receivable or monitor physician productivity, nor was there much incentive to do so. Employing organizations also didn't have the foresight to maximize additional revenues through ancillary tests and procedures being captured by these practices. And at the end of the day, in most markets, physician employment represented a zero sum game, with little change in market share or referral relationships.

The past 15 years have provided healthcare organizations with documented experience and improved data to structure physician employment arrangements in a more prudent manner—where both parties can realize certain benefits they may otherwise not have gained.

Factors Driving Physician Employment Today

The factors that have influenced growing acceptance of employing physicians run the full gamut, from geographic

to financial to personal. Nearly one in five Americans (56 million) is medically disenfranchised, meaning they have inadequate or no access to primary care physicians because of the shortage of such physicians (“Primary Care Physician Shortage Increases Medically Disenfranchised,” *American Family Physician*, April 15, 2007). This growing physician shortage drives demand for not only primary care physicians, but also specialists, particularly in certain geographic regions.

Based on lessons learned during the early 1990s, providers now are better able to structure the employment agreements with proper incentives to financially motivate employed physicians. These incentives often include a tiered productivity schedule with incremental bonus values and/or direct expense maximums.

For physicians, the personal advantage of physician employment is the ability to better balance work and family.

Employing physicians eliminates random on-call coverage, 10- to 12-hour days, and the many extra hours spent beyond patient care on practice operations.

Hospitals also benefit from physician employment and now have documented evidence of the strategic implications and advantages that can be achieved. Many rural hospitals that operate emergency departments don't have adequate specialty medical staff. Continually paying for call coverage or hiring locum tenens physicians is costly, while the increased ability to adequately admit patients and to avoid diversion could assist in balancing the cost of employment.

Additionally, employment has proven to be a viable defensive measure to growing competition. Healthcare organizations that employ physicians within their service areas may also have better referral patterns and consolidated practice operations. And often, employed physician

practices and their hospital employers are connected through electronic medical records, creating greater coordination and more efficient patient care.

The Influence of Market Characteristics

Market characteristics have influenced physician employment arrangements. In the more urban areas, the higher percentage of uninsured is deteriorating physician reimbursement. Urban areas also generally have a much more concentrated supply of physicians per capita. This abundance of physicians usually increases competition, rendering private practice a highly competitive experience. It also creates a double-edged sword for healthcare organizations, which find they must pay a premium to physicians for coverage or vacancies. Coverage may be viewed as a particular burden by physicians, since agreeing to on-call duties may also obligate them to assume responsibility for continuity of care, which in many cases could be uncompensated.

Physicians who feel the pressures of increased competition often pursue employment opportunities because they understand the market drivers and try to benefit from them as much as possible. This unique market characteristic, where there is high supply, doesn't necessarily mean there is an inverse demand. Contrary to the basic principles of economics, this market phenomenon creates more of a directly proportional relationship that can create greater leverage and economic opportunities for physicians that remain in these urban areas.

Rural areas of the country face the opposite situation. These areas tend to have fewer physicians per capita than urban areas and pose recruitment challenges. Physicians who practice in these areas are either overwhelmed because they are the only practices available for a more densely populated area or they are too far from a major population base to build significant practices.

Malpractice expenses continue to burden physicians, and are a major consideration when physicians are deciding where and how to practice medicine. Malpractice insurance can represent a significant practice burden that can potentially be alleviated through employment in instances when an employer is responsible for this expense.

Potential for Significant Gains

In some markets, physician employment is crucial to maintaining market share and remaining competitive, and healthcare executives are committing more time and energy to ensuring that employed physicians fulfill community and organizational needs in a fiscally sound manner. Providers that struggle with specialty coverage often find that the downstream revenues from employed practices are an attractive result of physician employment.

The financial risk for the employing organization may be minimal, while the resulting gain in inpatient revenues

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and decrease in referrals outside of the organization, for what in the past may have been a specialty not provided, often keep the employing organization in the black. Primary care practices, on the other hand, as a result of their payment structure, need significant professional fee volume (rather than inpatient admissions or referrals for ancillary services) to cover expenses. Healthcare organizations with a more broad perspective are often willing to tolerate a short-term start-up loss that will be eventually be offset by resultant downstream revenue.

Strategies for Physician Compensation

Regulatory changes have made the determination of the value of a practice less cumbersome, yet simultaneously somewhat more nebulous. Organizations that are interested in hiring a physician or group need to determine the fair market value (FMV) of the particular practice. The federal government defines FMV for (potentially) employed physicians as an hourly rate equivalent to the “average of the 50th percentile national compensation level for physicians with the same specialty, in at least four specified national surveys” (*Fair Market Value: Preventive Medicine for Physician Contractual Arrangements*, DGA Partners, 2006). It is likely, however, that these benchmark requirements will be done away with in the near future.

From the perspective of the employing organization, life is a lot simpler; however, the randomness of national surveys can often confuse or skew the FMV of the physician or group. Local surveys often better reflect the healthcare trends and issues in a specific area that may not be evident or are diluted somewhat by using national surveys. Specialty practices may find this phenomenon even more apparent, so it is important to determine FMV

with the most appropriate data resources. The final determination of FMV should then be compared with the cost of alternative services that could be used to fill the void.

The progression toward physician employment is not without challenges. The employment contract should be explicit regarding the expectations for physicians and the requirements for employers to provide timely and accurate data that will assist physicians in maintaining proper, expected practice behaviors. To ensure that the contract structure doesn't promote physician entitlement behavior, employers should set the starting base compensation at an appropriate level and avoid disincentives to meet desired productivity levels.

There are still physician practices that enjoy the autonomy of private practice and will continue to refer to and have privileges at hospitals and systems. Employing organizations should be careful not to create divisiveness between these two components and should effectively communicate why a physician or practice was purchased or converted to an employed group. Without full organizational understanding of the reasons for such a change, internal competition may develop and physicians that feel left out may change their referral patterns.

Lessons learned from previous physician employment arrangements and the evolution of the healthcare industry itself have made physician employment a much more viable and attractive solution for both employing organizations and physicians. Organizations seeking to fill vital shortages or vacancies for ED coverage, cognitive medical specialties, or surgical specialties can typically achieve their goals more selectively and efficiently

The employment contract should be explicit regarding the expectations for physicians and employers.

through physician employment. Meanwhile, physicians will be assured greater stability in income and practice patterns. Although organizations that employ primary care physicians may operate at a loss, the true strategic value of physician employment may justify this approach. Providers should consider whether the newly captured ancillary revenues and downstream benefits from hospital admissions of the employed primary care physicians outweigh any real dollar loss that may be incurred.

Contractually, physician employment agreements can be structured to benefit and satisfy both parties: Organizations will be guaranteed cost and productivity output while physicians will gain peace of mind and financial stability. And in optimum situations, the right incentives can drive productivity and downstream volume to levels the hospitals or systems may never have experienced. ☞

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