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Determining the Value of a Physician Practice

By Samuel H. Steinberg

By evaluating the strategic impact of a physician practice on your organization, you can better determine its value as a candidate for purchase.

As more healthcare organizations decide whether to purchase a physician practice to support their clinical programs, the need for reliable methods to evaluate the financial value of a physician practice has grown accordingly. Unfortunately, many decisions regarding the purchase of physician practices have not supported the overall mission of the organization, and often, organizations have lost money on these transactions.

Many hospital executives say the reason these transactions have not worked is because physicians exaggerate the volume of business they bring to the hospital, and some stop working as hard as they did when they were the owners of the practices. While both statements may be true, the major cause of failed transactions is the frequent lack of a strategic evaluation of a practice, its referral patterns,

and the current and future impact of the practice upon the healthcare organization in terms of diagnostic and therapeutic procedures, surgeries, admissions, and its fit with other practices supporting the organization. Such an evaluation allows administrators to determine the way in which a practice will fit into the strategic plan of the healthcare organization as the practice currently functions, not as administrators hope to change it.

The First Step: Understand the Numbers

All too often, administrators assume they will be able to change and adapt the practice's referral patterns to their vision, not recognizing that a practice's referral network and practice pattern are the result of a long-term and often highly nuanced pattern of referrals and cross-referrals from many other physicians. Changing one seemingly insignificant aspect may

result in the practice suddenly being out of balance with its network. This could drastically change the volume of activity and, ultimately, the value of the practice.

Most physician practices cannot quickly or easily quantify the number of patients they refer to healthcare organizations, nor can they provide detailed information regarding the number and types of procedures and tests these patients receive. Physicians who have a good information system are ahead of the game; in the best circumstance, they maintain data from each of their participating insurers. Requesting this information from insurers is a good idea, with as much detail as possible on how many procedures, tests, and operations the practice's patient population has generated

and where these activities took place. Most insurers will have this information; some will not. Some will refuse to share it, requiring the data to be collected by the practice administrator and the physicians involved.

Estimate the Revenue

The next step is to translate the numbers of procedures, tests, etc. referred by the practice into an estimate of their net revenue for the healthcare organization. Taking stock of every patient day and every procedure allows the practice's real dollar impact to be calculated. This process is often overlooked because it is difficult to collect this information, but given the risks involved in buying a potentially underperforming practice, the effort is worth it. Healthcare organizations have the information and the ability to determine both the cash effect of a physician practice as well as the net profit.

Know the Patients

The next key factor to consider is patient demographics: Where do patients of the practice live, and what percentage of patients live in the primary and secondary service areas of the healthcare organization? How realistic is it that these patients will come to your organization if they currently receive services elsewhere? Too many purchases go awry when the organization assumes that patients will allow themselves to be redirected.


Taking stock of every patient day and every procedure allows the practice's real dollar impact to be calculated. This process is often overlooked because it is difficult to collect this information, but given the risks involved in buying a potentially underperforming practice, the effort is worth it.

What other physicians refer patients to the practice, and what are their relationships to your organization and to others? Which practitioners does this physician refer to? What is the degree of influence you might exercise over these physicians? It is particularly important to discern whether this practice currently refers to your medical staff or whether the practice refers to specialists outside your organization. Change is difficult. Discuss the potential purchase with key medical staff leaders to make certain it will bring value to the medical staff and the organization.

Another obvious issue is the payer mix of the practice. This is often a determining factor in whether to approach a practice. The payer mix has already been identified as desirable; however, it is worth looking at trends for several years to make certain no adverse changes have been occurring.

You may even wish to discuss the purchase with contacts at key insurers to make sure that there is no concern on their part. You just never know. Armed with this information, healthcare organizations can help to ensure that acquired physician practices become strategic partners of the institution. The physicians in the practice will understand what is expected of them and how they fit into the plans of the organization. The purchase valuation will be realistic. Most important, the goals in acquiring the practice will be clearly understood—and achievable.

Making the Right Decision—Strategically

Strategic partners on the medical staff are few and far between and should be highly valued by every administrator. A sound methodology for evaluating potential practice acquisitions is essential to achieving this type of partnership. 

Samuel H. Steinberg, PhD, is an associate consultant, Health Strategies & Solutions, Inc., Philadelphia (ssteinberg@hss-inc.com).