

HS&S Strategy OUTLOOK

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Will For-Profit Specialty Hospitals Threaten Your Market Position and Financial Performance?

In the last decade, independent for-profit ambulatory surgery centers, imaging centers, and other ambulatory care centers have eroded the financial performance of many not-for-profit community hospitals. The range of services in these independent facilities varies, but often encompasses ambulatory surgery, imaging services, endoscopy, and cardiac diagnostics. Some are more broad based; others focus on a single service, such as ophthalmologic surgery. Ownership may range from physician ownership, to investor-owned, to joint ownership by physicians and investors.

Investor owners include national, publicly traded companies such as AmSurg, HealthSouth, and Bariatric Treatment Centers of America. Investor owners may also be local real estate or health care services developers, motivated

by likely high rates of return, often as high as a 30 to 40 percent or more annual return on investment.

A more recent influence on the traditional services of not-for-profit hospitals is the market entry of for-profit specialty niche hospitals. The initiation of this trend is often attributed to the heart hospital operator, MedCath Corporation, but many other companies have emerged as competitors to established general hospitals.

How Have For-Profit Developers Gotten a Foothold?

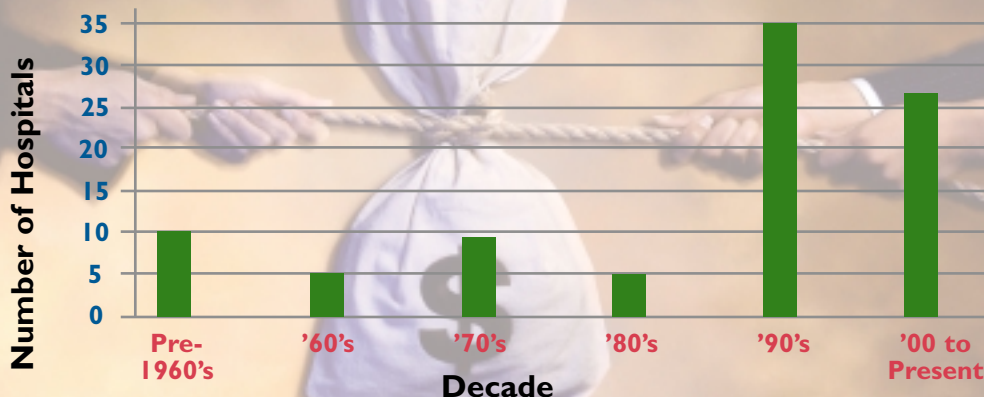
Physicians are often highly motivated to partner with these new for-profit developers of inpatient and outpatient health care services. Their motivation is usually fueled by several factors:

- **Pressure on physician practice margins.** Physician professional fee schedules have been on the decline when adjusted for inflation, while practice expenses, such as malpractice insurance, staffing costs, reimbursement, and regulatory demands have increased. Accessing technical fees through high-margin ambulatory services can generate incremental revenue to offset declines in professional fees and increases in practice expenses.
- **Access to capital.** Independent developers can be appealing business partners for physicians, particularly as a potential source of capital and an alternative to traditional sources of capital, such as banks.
- **Sour, or in some cases, hostile relationships between physicians and local hospitals and systems.** Previous attempts to collaborate with physicians, such as PHOs, risk contracts, practice acquisition, and employment, have, in most instances, created a divisive climate for future collaboration.

Often exacerbating these factors is a decline in the influence of certificate-of-need regulations, which have been eliminated in about 25 states, and in these states, no longer serve as a barrier to market entry for new program and service development. Technological developments, which enable many outpatient services to be provided out of the traditional hospital setting, are also fueling physician interest in partnerships with for-profit developers. These circumstances have converged to make partnerships with for-profit specialty providers an appealing option for physicians seeking more lucrative and personally fulfilling business relationships.

Opening Years of Existing Specialty Hospitals by Decade

The number of specialty hospitals has tripled since 1990. Another 20 specialty hospitals are being developed according to the General Accounting Office.



Source: General Accounting Office and Centers for Medicare & Medicaid Services, April 2003

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Competitive Responses

The ideal scenario for provision of community health care services is local hospitals working in collaboration with physicians on the medical staff and, if appropriate, outside for-profit developers. In a recent issue of *Modern Healthcare*, the new chief executive officer for MedCath stated an intention to work in a collaborative fashion with non-profit hospitals for future company growth and financial viability. This notion was expressed as “some new thinking and new relationships with our not-for-profit, acute care, brethren out there.”

However, a collaborative environment may be impractical and some health care markets may evolve into fierce competition. In these situations there are numerous competitive strategies that not-for-profit hospitals can implement to compete with or thwart the intrusion of specialty niche hospitals.

1 Take into account factors such as conflicts of interest and good citizenship when granting medical staff credentials and privileges. This concept is straightforward—termination of medical staff credentials and denied access to hospital facilities and services when physicians pursue competitive initiatives. The most significant detrimental effect on physicians is an inability to admit patients and perform procedures in a particular hospital. Other possible effects include difficulty retaining referral relationships with physicians closely aligned with the hospital that is terminating credentials. Lou Glaser, a partner with Gardner Carton & Douglas LLP, comments on this strategy: “Obviously, these types of actions raise legal issues, particularly antitrust concerns. To date, most courts have sided with hospitals that have restricted privileges or medical staff membership of physicians who own competing facilities. Nonetheless, hospitals that pursue these hardball tactics should do so carefully. A hospital’s motivation should not be based on a desire to harm competition, because the law views competition as beneficial.”

2 Disenfranchise competing practices by excluding them from payor contracts that a hospital or system has the clout and market presence to negotiate. Physicians, employed or formally aligned

with hospitals and systems, typically benefit from favorable third-party payor payments that are not available to their independent private practice physician colleagues. For example in one upstate New York community, private practice physicians have negotiated payments from commercial payors representing 110 to 115 percent of the Medicare fee schedule. A large, hospital-aligned multispecialty group practice in the same community has a more favorable rate of over 140 percent of the Medicare fee schedule.

3 Restrict the network. For those health care organizations that still own some or all of a managed care plan, the hospital or system can require the use of hospital-owned or affiliated sites and services, particularly for hospital and health system employees. A competitive entity, such as a physician-owned ambulatory surgery center, would not qualify. This strategy can be particularly effective if payors and employers agree to restrict the provision of services to certain providers. For example, hospitals are often the largest employers in a particular market. As such, hospitals can wield significant leverage regarding where employees are able to seek care.

4 Foster competitive recruitment. Separate physician practices on a hospital medical staff are often competitive with one another. A hospital can foster further competition by helping the more closely aligned practices with physician recruitment. In the case of a hospital in suburban Philadelphia, two cardiology practices have added ancillary services, historically the bailiwick of the hospital, to their practices, including EKGs, echocardiography, stress testing, Holter monitoring, and nuclear imaging studies. However, the hospital medical staff has been dissatisfied with service levels provided by these two practices, particularly service to unassigned ED cases and response time for subspecialty consults to other services. The hospital’s approach to these issues has been to recruit a competitive cardiology practice and grant competitive practices access to reading cardiac diagnostic services in the hospital, participating in ED call coverage (to build practice volume through unassigned call patients), and competing

with the existing groups for clinical referrals.

5 Refuse to provide a transfer agreement. In many states, in order for a niche specialty hospital or ambulatory care center to gain state licensure, it is often necessary to execute formal transfer agreements to acute health care facilities should cases require more acute intervention. A hospital could refuse to execute a formal transfer agreement between a freestanding physician-owned ambulatory surgery center and the hospital’s emergency department, intensive care unit, and inpatient beds.

6 Promote price competition. A hospital may discount prices to insurers for services provided by a competitor, such as a specialty niche hospital.

7 Offer retention bonuses to nurses and other valuable technical staff. Retention programs may be sufficient incentive for staff to remain at the hospital or system to prevent the loss of staff to a competitor, such as a for-profit specialty hospital. One mid-Atlantic health care system compensates nurses \$5,000 per year for a retention bonus over a five-year period for continued employment with one of four hospitals in the system. In some cases, retention bonuses are structured with back-end loading, which provides higher payments in latter years to ensure a long-term commitment. For example, payments can be made over a five-year period, with \$1,000 in year one, followed by annual payments of \$3,000, \$5,000, \$7,000, and \$9,000.

8 Strengthen strategic alignments with loyal, noncompetitive practices. In some cases, physicians who are closely aligned with, rather than competitive with, a health care organization are eligible for joint ventures, management contracts, and other formal business relationships with the hospital or system. In some cases, hospitals have fostered strong referral relationships among loyal physician practices.

HS&S Is Looking For a Few Good People

Health Strategies & Solutions is seeking qualified candidates for entry-level consultant positions and an entry/mid-level analyst position.

For the consultant position, candidates should be highly motivated, early career professionals with a master's degree in business or health administration or a similar field and two to three years of health care planning and management experience. Solid analytical and communication skills are required. Prior experience in a provider setting or in a consulting or project-oriented environment is preferred. Entry-level consultants will provide client support for a diverse mix of engagements.

Candidates for the analyst position must have a bachelor's degree and strong quantitative and analytic skills, preferably with some health care experience. This position focuses on database management and development of analyses and datasets to support product development and consulting engagements.

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Interested candidates should submit a resume to:

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9 Facilitate practice promotion and marketing. If a physician practice is aligned with a hospital or system, rather than a competitive entity, then the practice may be eligible for various practice promotion activities. Examples include participation in a hospital telephone and website referral program, involvement in other promotional initiatives (e.g., brochures, yellow pages, etc.), and access to ED call coverage, which may be an important vehicle for accessing unassigned patients.

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Lou Glaser, a partner with Gardner Carton & Douglas LLP

10 Rouse community pressure. In one rural community, hospital-affiliated physicians planned to open an independent ambulatory surgery center. Through a letter-writing campaign to the local newspaper, hospital management was able to exert sufficient community pressure, which one physician said manifested itself as “shame and guilt,” that resulted in the physicians abandoning their plans.

11 Consider lobbying efforts. In some cases, not-for-profit community hospitals are expending a fair amount of energy lobbying state and national legislative bodies to change the laws that allow physician investment in these types of hospitals.

Craig Holm is a director of Health Strategies & Solutions and oversees the firm's physician-hospital integration and physician practice consulting services. He is a frequent speaker for national and state health care associations and societies. In 2004, his new book, *The Medical Staff of the Future*, will be published by Health Administration Press.



Off the Press Recent Articles



“Could Your Financial Health Be Heading for Heart Break,” by Hugo Finarelli, August issue of *Healthcare Financial Management Magazine*

“Using Observation Units to Improve Clinical Outcomes,” by Maria Finarelli, August issue of *Health Care Strategic Management*

“Fundraising for Today's Times,” by Christie Markham and Alan Zuckerman, October issue of *Managing the Margin*

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On the Dais Upcoming Presentations



Hospital Planning and Marketing Society of New Jersey and the New Jersey Hospital Association

Tracy Johnson: “Service Line Business Planning: Bringing All Parties to the Table,” October 10 in Princeton.

Healthcare Association of New York State

Alan Zuckerman: “Strategic Planning: From Formulation to Action,” October 17 in Bolton Landing, New York

Amerinet Central

Christie Markham: “Market Opportunity: Diabetes Programs,” Teleconference, November 7

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Health Strategies & Solutions recently published its first electronic newsletter, *Strategies & Solutions*. If you received this newsletter, you should be receiving our electronic newsletter as well. If you did not receive our electronic newsletter or others in your organization would like to subscribe to our electronic newsletter, please go to:

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Above l to r: Robert Hill, Christine Markham, Keith Pryor, Tracy Johnson, Craig Holm, Alan Zuckerman and Hugo Finarelli

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