

Don't get out of joint

Physicians and hospitals should pursue joint ventures prudently



Joint ventures — shared equity investments by physicians and a hospital or system — while not new are increasing in their variety. The regulatory environment related to the structuring of joint ventures seems to evolve daily.

Joint venture relationships traditionally have been limited to ambulatory surgery and imaging services. Today, an assortment of programs and services offer themselves for joint venture relationships between hospitals or systems and physicians, including ambulatory care centers, endoscopy facilities, cardiac diagnostic services, urgent care, occupational medicine, sports medicine services, fitness centers and medical office buildings. For the purposes of this article, a joint venture is an entity owned, through equity investment, by physicians and a hospital or system. The entity provides health

care services and bills payors such as health maintenance organizations, Medicare and Medicaid.

Joint ventures are proliferating for several reasons:

- Some organizations are trying to salvage economic integration with physicians despite the failure of other economically integrated models, including practice acquisition, employment and managed care risk assumption;
- Other hospitals and systems are now ready for joint venture relationships due to the elimination of certificate-of-need regulations that served as barriers to the development of programs and services by any party — hospitals, systems or physicians; and

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- More flexibility within recently enacted regulations has cleared the way for joint ventures.

While there are more clearly defined stipulations and restrictions for the formation of joint ventures, many are now clearly permissible. For physicians, joint ventures can offer attractive new revenue streams as professional fee income remains flat or declines.

While the goals and objectives, expectations and models vary widely to suit specific joint venture situations, certain guidelines heighten the probability of success and help create a strong foundation for the relationship.

The more significant outcome in a joint venture relationship is the increased efficiency and productivity achieved through investment and ownership.

Don't fixate on a joint venture as the only solution

Hospitals, systems and physicians bring different expectations to the bargaining table. Physicians often seek access to capital and approaches for offsetting declining professional fees as they work harder for the same or less reimbursement. Control is also a key factor. Physicians in private practice — with ultimate control — often feel frustrated by the lack of control and influence on a hospital's operations and services.

Hospitals and systems, on the other hand, look to maintain or expand service lines rather than lose revenue streams as the Balanced Budget Act, competition, payor initiatives and other factors erode reimbursement. Potentially significant reimbursement decline is occurring in states such as Ohio, North Carolina, Pennsylvania and Maryland, where certificate-of-need regulations — historically a barrier to the development of new

programs and services — are being eliminated or will most likely disappear.

Given the disastrous financial results from previous alliances with physicians that resulted in huge operating losses for hospitals and systems, health care organizations should pursue equitable relationships with physicians that feature risk and reward commensurate with the level of investment and commitment.

Models other than joint ventures may accomplish participants' objectives as effectively or more so than joint ventures, and leaders can use them as a starting point for moving on to more integrated relationships:

- **Management contracts** — These are negotiated with the understanding that a physician interested in helping to build or enhance a program or service will be paid for a certain number of hours per week or month;
- **Joint operating agreements (JOAs)** — This is an economic alignment strategy that secures physician participation in clinical, operational and other initiatives. JOAs can take a variety of forms, from clinical protocols to service agreements agreed to by all parties. Because no equity is involved, JOAs are less financially binding than joint ventures; and
- **Sale of services** — Rather than competing head-to-head with physicians over select ambulatory services, some hospitals and systems are opting to sell or contract out selected outpatient services, such as dialysis and radiology programs, to entrepreneurial physicians.

Establish criteria for prudent development

Thorough and thoughtful planning prior to formalizing a joint venture contract ensures that both parties have the same expectations for the initiative's outcome. Consider the following:

- **Duration** — Five years or longer is a good target because it is long enough to accomplish something, yet not so extended that market influences and dynamics can vary substantially.

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- **Consistency with strategic goals and objectives** — From the physician perspective, does the practice want to align with a particular hospital or system and vice versa? Are expectations and cultures compatible? From the hospital's perspective, which specialties, programs and geographic areas represent the highest priority for potential joint venture partners?
- **Return on investment** — The return for the hospital, physicians and any outside investors should be attractive but not excessive. To sell the concept, the return on investment should be superior to other investment options, such as certificates of deposit, equity markets and real estate. Investment should be a prerequisite for gaining control and influence on the management, organization and operations of services included in the joint venture.
- **Degree of erosion** — From the hospital, this is likely; from the practice, it is unlikely. Ideally, the erosion of patient volume and revenue will be minimal; instead, potential for the expansion of services should be demonstrated. The venture should offer potential for additional market share and related revenue streams. Tied to this analysis should be the opportunity for "backfill" of services in the hospital, as it uses the newly available space to develop other programs and services, relieve capacity or space constraints and improve operational efficiency.
- **Vulnerability or risk of doing nothing** — Many attempts to broker physician-hospital alliances have failed to add value for either party and often have resulted in deep financial losses. But with increasingly compelling evidence that their futures are inextricably linked, hospitals, systems and physicians must keep trying to forge alliances grounded in trust and shared governance. The parties must demonstrate commitment to enhancing quality and controlling costs, rather than controlling referrals.

Maintaining the status quo or letting past failures prevent future collaborations represent risky directions. Many CEOs believe it is

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better to maintain 50 percent of outpatient surgery volume by structuring a joint venture with physicians than to lose it all by failing or refusing to reach an agreement. And as a result of the goodwill associated with economic integration, program growth may ensue.

Provide thorough financial projections for investors

Physicians who invest in joint venture relationships commit their personal funds to the undertaking, unlike hospital or system executives who contribute organizational funding. To ensure that all parties recognize their level of investment and expected return, provide carefully prepared financial projections and discuss them to ensure that expectations align with probable outcomes. These statements should include:

- Summary financial projections (expressed as net present value) of the joint venture, stated conservatively to avoid raising false hopes; and
- Estimated return on investment for all investors.


It is extremely important to be conservative when estimating the return on investment for capital investments that commonly mature when competitors catch up. The more significant outcome in a joint venture relationship is the increased efficiency and productivity achieved through investment and ownership. For example, the efficiencies of a joint venture in an ambulatory surgery center might allow a surgeon to perform eight cases instead of six in the same amount of time.

Be aware of the constantly evolving legal environment

Joint ventures are particularly difficult to structure for the “designated health services” articulated in the Stark physician self-referral law. Consult early and often with legal counsel before raising physician and hospital expectations about potential joint venture relationships.

Communicate joint venture guidelines

Hospital administrators should keep medical staff apprised of guidelines and priorities for joint venture development. Otherwise, providers will perceive hospital leaders as “doing deals” and playing favorites as they structure these alliances.

Many agreements with physicians in the last decade were structured haphazardly, with little forethought about the long-term ramifications for both sides. As a new generation of joint venture arrangements emerge, physicians, hospitals and systems will all benefit from prudent, thoughtful planning so that reasonable expectations and a collaborative spirit characterize the partnerships — and enhance the potential for success. 

Lessons learned in developing successful joint ventures

- Don't fixate on a joint venture as the only solution
- Establish criteria for prudent development
- Provide thorough financial projections for investors
- Be aware of the constantly evolving legal environment
- Communicate joint venture guidelines