

COVER STORY

Daniel M. Grauman
John M. Harris



healthcare financial management association www.hfma.org

3 durable strategies for physician alignment

Today more than ever, choosing the right physician strategy is critical for hospitals.

Even before the current financial crisis, hospital and health system leaders were struggling to identify the best physician alignment strategy for their organizations.

The current financial crisis may have added some complexity to this effort, but it hasn't diminished the need for such a strategy.

In many ways, the time is ripe for a closer working relationship between physicians and hospitals. Physicians may be more receptive to aligning with hospitals than they have been in the past (see the sidebar on page II). The current economic environment is likely to increase financial pressure on physicians, leading more to seek employment or other support from hospitals.

But losses on investments and from more uninsured patients will reduce resources available to hospitals for investing in physician strategies.

Hospitals are also experiencing reduced volumes as patients postpone elective procedures, further depressing profitability. Already, increased borrowing costs may have made some strategies, such as physician-hospital joint ventures, less attractive than in the past (although these strategies have continued viability in some circumstances).

Three compensation-based physician alignment strategies, each with different costs and rewards, remain broadly attractive in the current environment and therefore merit special consideration:

- > Physician employment
 - > Professional services agreements (PSAs), including medical directorships and on-call coverage
 - > Income guarantees
- Judiciously combined, these three approaches to physician alignment can help to achieve strategic and operational goals, including:
- > Securing or growing a hospital's primary care base or specialty medical staff
 - > Responding to specific clinical market opportunities
 - > Protecting services that make significant contributions to a high margin (e.g., ancillary services)
 - > Meeting coverage requirements
 - > Strengthening quality of care initiatives

AT A GLANCE

- > Physician employment, professional services agreements (PSAs), and income guarantees are three effective compensation-based strategies hospitals can use to achieve physician-hospital alignment.
- > In choosing one or a combination of these strategies, hospitals should assess the strategic, regulatory, and financial considerations associated with them.
- > Each strategy raises different implementation concerns—for example, employment presents the issue of compensation, PSAs involve greater regulatory constraints, and income guarantees test the long-term loyalty of physicians.

Read John Harris's comments on the broad effects of the nation's economic challenges on health care at www.hfma.org/hfm.

By understanding the strategic, regulatory, and compliance considerations associated with each approach, hospitals can begin to choose and combine these approaches to best achieve their goals.

Strategic Considerations

When evaluating the strategic considerations involved with each of these compensation-based strategies, two points warrant special emphasis. First, all other things being equal, the more closely the alignment strategy integrates the physician group with the hospital or health system, the greater the benefits it will provide. Second, the success of the effort will be largely determined by the attitudes and influence of the physicians and groups involved or affected.

With these points in mind, employing physicians is perhaps the most appealing strategy because it provides the closest ties to the healthcare organization and is most likely to result in the desired physician behavior. Employment also has the potential to achieve the broadest range of goals—as long as it also meets financial and regulatory criteria and suits the physicians' attitudes. Those

are significant caveats, however, which is why physician employment is usually only one element of a physician alignment strategy.

Moreover, although physician employment may be a more viable alignment strategy than in the past, it's not necessarily the right one for every hospital, or for every physician for that matter. Therefore, to determine the extent to which any or all of these three strategies would have the desired effect in bringing the hospital and physicians together, it is necessary to carefully assess each strategy in light of the hospital's strategic and operational goals—particularly with respect to referral base and growth, ancillary revenue, on-call coverage, and quality of care.

Referral base and growth. Employing physicians provides the most direct and strategically lowest-risk way to respond when the hospital has identified a need to grow its referral base or secure it from erosion, or when physician groups are not responding to growth opportunities in specific specialties. Employment offers the significant advantage that employed physicians can be required to use the employing hospital's facilities, as long as the physicians and their patients have the option to go elsewhere when the alternative site holds the promise of better clinical care, especially for tertiary or quaternary services.

Some physicians, however, may be strongly opposed to being employed by the hospital. The market may not be ready, or powerful physician groups on the medical staff may object to the approach. In this situation, it may be more politic to provide incentives for groups to add physicians through income guarantees for new physicians (where community need can be demonstrated, as is discussed under the heading of "Regulatory Considerations" on page V).

Providing an income guarantee for new physicians for a start-up or loyal practice can be a productive approach to increasing the supply of physicians. However, its impact may fade once the guarantee period (typically one to two years) is completed. Also, there is no way to guarantee referral patterns.

The decision whether to use income guarantees or physician employment is based partly on the

Physician Attitudes: A New Climate

Changing physician attitudes are providing health systems and hospitals with new physician alignment options and increasing their need to use others. Not long ago, the specter of a hospital employing physicians would have been likely to trigger a major battle with the medical staff, complete with physician threats to move their referrals and admissions to other hospitals.

In the past several years, the climate has changed. Physicians today are more willing to trade off independence for lifestyle, and an entrepreneurial mode for financial security. Many are seeking a work environment that will protect them from rampant malpractice costs and continued decreases in reimbursement. Uncertainty in the economy is likely to accelerate this trend.

It has become common to hear physicians say, "My practice is losing money." What they mean is that they want their draw to be higher than what the reimbursement and practice expense environment allows. Employment is one way out of this dilemma.

The financial squeeze has also reduced physician willingness to take the risks associated with adding physicians to their practices. Even where a physician group sees a market opportunity, the physicians may feel that they can't afford to absorb the impact on their professional income while a new physician starts up with the group. So hospitals may have greater need than in the past to provide physicians with support to encourage their practice growth.

philosophical outlook of the hospital or health system, and partly on the outlook of the physician practices. Income guarantees will fit best where new physicians wish to remain independent, or where existing physicians are happy to grow their practices without assuming the risks and without having to compete with employed physicians at the hospital.

Income guarantees also can be a good bridge strategy—for example, where the attitude toward physician employment is visibly changing but the option is not yet politically feasible.

A PSA is an effective strategy if the goal is to develop clinical programs in targeted service lines with physicians already on the medical staff.

Protecting ancillary revenue. Pressure on physician revenues is motivating many physician groups to develop their own ancillary services that compete with hospital services. When a hospital has ancillary services that contribute heavily to the margin (e.g., endoscopy or radiation oncology), loss of that income is a significant threat.

Pursuing a joint venture with the physicians may preserve some of this revenue, but possibly less than half. A joint venture will generally receive lower payment for a service than the hospital, and that revenue must be split with the physicians.

Employing physicians, however, offers an effective way for a hospital to protect its essential ancillary services revenue, as the employed physicians would not develop ancillary services.

Some of the same benefits of employing physicians to prevent ancillary service competition

also can be achieved by setting up extensive PSAs and income guarantees. The more physicians are perceived as connected to the hospital, the more a group of physicians will think twice before creating a competing ancillary service.

Moreover, when a hospital's physician enterprise reaches a certain size, establishing an ancillary service in competition with the hospital will appear less appealing to voluntary medical staff members because they will be less confident of their ability to attract enough volume to sustain the ancillary service on their own. Moreover, by competing with the hospital's service, and potentially losing referrals from hospital-employed physicians, the independent physician may put core professional services revenue at risk.

A hospital can be in a bind when trying to protect its ancillary services from competition developed by large specialty practices. These practices often have the scale to negotiate successfully with payers on their own, and are also better positioned than other practices to develop ancillary services as an additional source of income. For these reasons, these practices are both the least likely to choose employment and the most likely to set themselves up in competition with the hospital. In this situation, a joint venture relationship, or even a comanagement agreement, with the physician practice may be the most attractive option.

Coverage. Traditionally, physicians have provided on-call coverage at no cost as part of their medical staff obligations. As physicians have felt increasingly pressured to maximize their revenue-producing hours, they have become less inclined to provide free coverage.

COMPENSATION-BASED PHYSICIAN ALIGNMENT STRATEGIES RELATIVE TO GOALS

	Growing Your Medical Staff	Targeted Clinical Market Opportunities	Quality of Care	Ancillary Revenue	Coverage Requirements
Employment	●	●	⊙	●	⊙
Income Guarantees	⊙	⊙	○	○	⊙
Professional Services Agreements	○	⊙	○	⊙	⊙

Key: ● High ⊙ Medium ○ Low

All of the compensation-based physician alignment approaches can be used to address coverage issues. Employed physicians can be required to provide coverage outside of office hours. Income guarantees can help build the number of physicians available to provide coverage, particularly if on-call coverage is made a condition of the guarantee. PSAs and directorship agreements are a relatively low-profile approach to rewarding physicians for their services to the hospital, including on-call coverage.

There also is a growing use of “ists” to provide inpatient coverage—hospitalists, intensivists, nocturnalists, and even laborists. These physicians can be employed, or can work under a PSA.

The choice of which alignment approach to use in a coverage situation is often a function of which physicians are available in a given specialty and their preferences. Sometimes a contractual arrangement with a multispecialty group can provide coverage across a range of specialties, and the hospital can gain the full loyalty of the whole group.

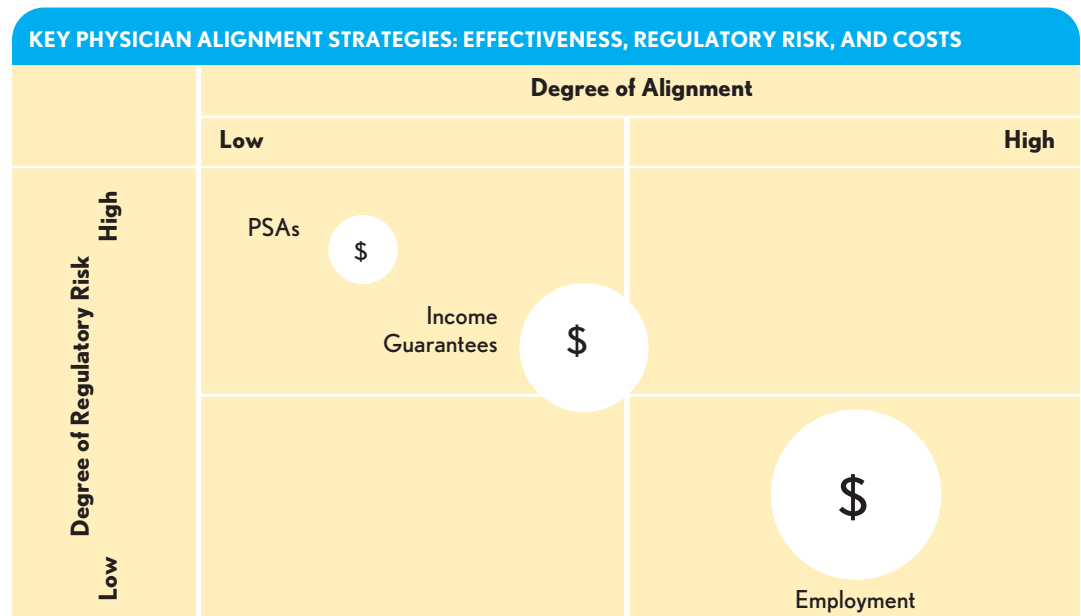
Quality of care. Hospitals and health systems increasingly see a need to better manage quality of care, and to integrate physicians into this process. Physician employment provides the greatest opportunity to engage physicians, and therefore the best opportunity for integration of clinical guidelines into the medical practice.

When a large number of physicians are employed, a hospital is well-positioned to extend its inpatient care quality initiative into ambulatory care. It is more economical, as well as politically and operationally simpler, to implement an electronic medical record (EMR) system that extends to the offices of employed physicians than to independent members of the medical staff. With an EMR in place, clinical guidelines can be extended beyond inpatient care into ambulatory and office-based care.

PSAs, and to a lesser degree income guarantees, can provide some advantages in engaging physicians in a hospital’s quality-of-care initiatives. Income guarantees can make physicians more amenable to these initiatives by enhancing the relationship between the physicians and the hospitals. And a PSA that involves departmental leadership and teaching can secure physician participation in such initiatives by making involvement in the development and “enforcement” of clinical guidelines defined responsibilities of the position. Once physicians are adhering to guidelines in one context, they are likely to do so in other aspects of their practice—and influence their colleagues to do so as well.

Regulatory Considerations

Meeting regulatory requirements for physician employment is a relatively simple matter. Regulations are a more significant challenge to PSAs, however, and income guarantees are still



The size of each circle is proportional to the typical cost of the strategy.

more difficult. Key considerations in any case are community need and compensation fair market value (FMV).

Community need. In an income guarantee situation, it is necessary to demonstrate community need, because the goal of the guarantee is to bring a needed physician into that market. Sometimes, however, a hospital cannot demonstrate community need in a geographic area because of physicians affiliated with other hospitals. In such instances, if the hospital wants to target development in a particular specialty, employment or PSAs are viable options, because hospitals are not required to demonstrate community need with either of these approaches.

Compensation fair market value (FMV). All three alignment strategies require that compensation be made at FMV. With physician employment, regulatory concerns regarding compensation focus primarily on IRS concerns about private inurement, whereas with PSAs, there is more concern about a hospital appearing to be paying for referrals as prohibited by Stark and Medicare anti-kickback provisions.

It is typically easier to meet FMV requirements in employment than in PSAs. Most important, whatever approach is used must comply with federal law dictating that compensation may under no circumstances provide incentives to induce additional referral volume.

Fair market compensation must be based on appropriate benchmark data for physicians in the same specialty or subspecialty and performing in the same role. It must be based on careful determination of service levels, whether for patient care and coverage or administrative, supervisory, and teaching activities. Innovative approaches can be required to maintain regulatory compliance of financial arrangements while meeting physician expectations.

Financial Considerations

With many hospitals experiencing losses on their investments and facing reduced payment, the financial implications of different physician alignment options come into sharper relief. However, these strategies are long-term commitments, and decisions about them should not be overly influenced by short-term financial issues. Hospitals and health systems with stronger bal-

ance sheets will be able to take advantage of the current situation by pursuing strategies not available to their weaker competitors. In addition, physicians may be more interested in reaching agreements, possibly yielding more favorable terms for hospitals.

Physician employment provides the greatest opportunity to engage physicians, and therefore the best opportunity for integration of clinical guidelines into the medical practice.

Employing physicians requires significant up-front investment. It may be necessary to acquire a physician's existing practice, or to fund losses during the start-up of physicians who are new to practice. Infrastructure investments, such as billing systems, are required to properly manage practices. Investment in an EMR system is essential to get the maximum benefits from physician employment.

When physicians are employed, hospitals can negotiate with payers on their behalf, typically achieving somewhat better results than the physicians can get on their own. The hospital also handles malpractice insurance. Physicians often find that their overhead is a little higher, but more predictable than would be the case in private practice.

Many health systems and hospitals have found themselves losing money on the practices of employed physicians, sometimes as a result of offering the physicians a guaranteed salary. When compensation is properly structured, it is possible to control or avoid losses, but from a strategic viewpoint, avoiding all losses may not be desirable. In some instances, a loss on the professional service revenue of particular physician practices due to compensation may be more than offset by the value of having the physician as a reliable referral source and thus may net the best results for the hospital enterprise as a whole.

Income guarantees typically involve more limited financial exposure and are easier to manage. The risk is limited to the possibility that a new physician is unable to achieve the volumes needed to provide adequate compensation within the period of the guarantee. In such an instance, the practice could request an extension, leading to negotiations that could strengthen or weaken its alignment with the hospital.

PSAs can create significant financial risk if not managed carefully. The hospital not only must demonstrate to regulators that the medical directorships and other positions are providing concrete value, but also must give other physicians the assurance that these positions are not union no-show jobs. If that is not done, there can be a slippery slope to the point where all physicians start seeking compensation for every task that isn't paid by an insurer.

Physician alignment strategies are long-term commitments, and decisions about them should not be overly influenced by short-term financial issues.

Key Implementation Concerns

Achieving success with any of these alignment strategies depends on careful implementation. What may appear to be small considerations can make all the difference in whether alignment goals are achieved. Each strategy raises its own special implementation challenges, so they are addressed below for each strategy in turn.

Physician employment. When a hospital employs physicians, it bears all of the risks and burdens of the physician practices, ranging from practice overhead, to the need to motivate physicians, to coping with potential physician dissatisfaction. Of course, with the proper implementation, the hospital also receives all the strategic benefits.

In short, financial considerations are most critical in successful implementation of an employ-

ment program. The hospital should be careful not to overpay when acquiring the physician practices, because it may never be able to recover a high acquisition cost. It is also critical to bring the physician enterprise to the attention of payers during contract negotiations. Payment should reflect the superior integration and management of care in a hospital-owned physician enterprise, as long as the payers see evidence of progress toward delivering on these promises.

The compensation of employed physicians should be set at an FMV level. Within the range of FMV, compensation should recognize that physicians in private practice can increase their income by including ancillary services in their practices. In an employment model, this additional revenue stream is not available to the physicians because the hospital retains the ancillary volume.

Proper compensation design and attention to expenses helps to control losses. Straight salary compensation should be avoided because it buffers the physicians from every reality they would experience in private practice, and is practically a guarantee that the hospital will lose money because it does not align physician and hospital incentives. Compensation based on relative value units provides incentives for volume, but still shelters physicians from a wide range of factors affecting practice revenue and expenses and, ultimately, the practice's bottom line.

Increasingly, physicians appreciate a practice setting that rewards them as if they were in private practice. Paying physicians, in whole or in part, on a net practice income basis provides this kind of incentive. Physicians still obtain the financial benefits of improved payer contracts and lower malpractice costs.

In addition, as pay-for-performance trends influence the market, compensation mechanisms will need to become ever more sophisticated, using metrics pertaining to clinical outcomes, patient satisfaction, and adherence to clinical guidelines.

The integration made possible by an EMR can enable a hospital to optimize the benefits from employing physicians, improving its return on expenses. An EMR that extends into physicians' offices should be implemented wherever there is

a sufficiently large physician enterprise, to improve integration of care, extend the use of clinical guidelines, and increase the ability to monitor quality of care.

PSAs. The most significant concerns in implementing PSAs are regulatory constraints, and the need to control the slippery slope risks cited previously that could make PSAs an expanding part of the hospital budget. PSAs also must be managed carefully and consistently to avoid sparking physician discontent worse than that which they were being used to quell.

The greatest regulatory concern regarding PSAs is that they could be construed as payment for physician referrals. As a result, hospitals must be meticulous in conforming to FMV requirements. This concern can make it difficult for both the hospital and the physician to meet their goals for the arrangement. Hospitals want to put enough on the table to get the deal done, but not more than necessary, while physicians often push for high compensation relative to hours spent. Convincing physicians that your offer cannot be higher due to federal regulations can take a convincing written case and a light touch.

Techniques that can help hospitals successfully manage the risks of PSAs include benchmarking compensation for the physician specialties and roles involved and creating position descriptions that define the administrative, supervisory, and teaching activities to be provided. Level-of-effort agreements and monitoring systems should be put in place.

Obtaining an external FMV opinion protects the hospital and makes it easier to deal with physicians' expectations. Once an arrangement is in place, it is essential that the hospital protect itself by keeping a consistent and accurate record of physician hours spent, logged as they occur.

Hospitals also should adopt a rationale to control undesired expansion of PSAs. For example, PSAs could be limited to situations in which there is community need or insufficient staff in a specialty to provide seven-day coverage. Some hospitals, as a matter of policy, have established a fixed annual budget for on-call coverage, and then asked key medical leaders to establish a fair allocation mechanism.

Income guarantees. When providing income guarantees to support an existing practice in bringing in a new practitioner, the demonstrated loyalty of the practice to the hospital is of paramount importance. It also is important to design the guarantee so that the new practitioner has an incentive to grow his or her practice. If total income protection is provided for the entire length of the guarantee, the physician will face an overnight transition from full protection to no income protection when the guarantee ends. Because the existing practice will be determining the new practitioner's compensation once the guarantee is over, it is best to understand the practice's compensation design to be sure that the structure of the income guarantee will transition smoothly into their compensation plan.

A Full-Spectrum Solution

Every hospital faces a unique situation with regard to physician alignment, and there is no single optimal alignment strategy. Most hospitals will need to combine these three compensation-based strategies, as well as others, including joint ventures, to meet the full spectrum of their physician alignment needs. By understanding the strategic, financial, and regulatory benefits and burdens of each, a hospital can combine alignment strategies for maximum benefit. ●

About the authors



Daniel M. Grauman is president and CEO of DGA Partners, Bala Cynwyd, Pa., and a member of HFMA's Philadelphia Metropolitan Chapter (DGrauman@dgapartners.com).



John M. Harris is a principal with DGA Partners, Bala Cynwyd, Pa., and a member of HFMA's Philadelphia Metropolitan Chapter (JHarris@dgapartners.com).

PLANNING SERVICES

- > Strategic Planning
- > Business Planning
- > Financial Planning & Modeling
- > Facility Master Planning

PHYSICIAN-HOSPITAL ALIGNMENT

- > Medical Staff Planning & Development
- > Joint Venture Development
- > Physician Compensation Design
- > Physician Community Need Assessment

BUSINESS INTELLIGENCE & OPERATIONS

- > Healthcare Business Intelligence
- > Business & Functional Requirements for IT
- > Payer Contracting
- > Managed Care Operations

VALUATION SERVICES

- > Medical Practice Valuation
- > Business Valuation
- > Physician Compensation Fair Market Value
- > Litigation Support

Philadelphia

New York

Washington, DC

www.dgapartners.com
800 241-5268