

Hospitals & Physician Practices: How Delta Helps Build Better Relationships

For more than two decades, the partners of Delta Health Care have focused on the business of physician practice. Now more than ever, our specialized expertise is in demand by hospital CEOs who are looking at practice acquisition or are dealing with other hospital-physician practice relationship issues.

So we have expanded our Web site to spell out the consulting services we can effectively provide to hospitals and health systems. The feature article in this newsletter takes a look at how hospitals are getting smarter about acquiring physician practices. The article was too detailed to fit in our newsletter, so we invite you to visit our expanded site to read the full version: www.DeltaHealthcare.com.

Why Hospitals are Buying Physician Practices—Again

by *Randy Bauman*

Remember the Internet business craze of the late 90s? Anything with dot-com after the name had venture capitalists lining up to invest. We all know the end of that story. But think of the companies that survived: Amazon, eBay, Google. By all accounts, they're doing well and Internet entrepreneurs now look at those business models hoping to learn a thing or two.

And so it was with hospitals buying medical practices. This trend revved up full force in the early to mid 90s and everyone jumped on the band wagon. It was a feeding frenzy, and that was part of the problem. A few big companies and healthcare systems began buying practices and, not wanting to be left out of the fun, hospitals large and small all over the country followed suit. In many cases, they had little reason or need to own practices. It just seemed like the thing to do at the time.

Like a lot of trends, there is an initial wave – and then a big crash. But during this process a few people figure out how to make something work.

A history lesson

Back in the 90s, we consultants often had to hold our tongues as eager hospital administrators laid out their plans for rapid acquisition of physician practices. Many had no long-term strategy in place. Most had no idea how to manage a practice. Some were buying groups they couldn't afford and didn't need for the sole purpose of keeping a competitor from scooping them up.

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Holiday Greetings



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Recent Projects

- OH Assessment of a 50 physician multi-specialty group
- SC Development of a hospital strategy for physician acquisition and/or employment
- PA Interim management of a cardiology group
- AL Assessment and restructuring of hospital-based primary care practices
- FL Valuation of a primary care practice
- AZ Assessment and compensation restructuring for large emergency room physician groups
- PA Valuations of Internal medicine practice
- FL Income distribution revisions to comply with proposed changes in Stark Regulations for two large cardiology groups
- ID Operational assessment of a cardiology practice
- LA Valuation of an internal medicine practice

We worked with a nationally prominent hospital CEO who reacted with indignity when we had to tell him that the employment agreements he'd signed with physicians didn't allow him to fire them or even to dictate work hours or minimum production standards. The physicians had a sweet deal, and you can't fault them for having negotiated well. It's human nature to get all you can while the getting is good.

Here are **twelve lessons hospital administrators learned** during the process of buying – and then in many cases divesting themselves of – medical practices.

1. You can't pay ten times what a practice is worth and expect to recoup your investment.
2. How a physician employment contract is crafted is crucial.
3. Physicians work harder when they have a production incentive, as opposed to a long-term salary guarantee.
4. From a business standpoint, the only similarity between a hospital and a physician practice is that they both have patients.
5. Hospital managers do not generally make good practice managers.
6. Cash is king in a medical practice. Physicians don't understand accrual accounting systems, and if you use one they'll think you are hiding the money.
7. You can't do physician billing using a hospital system.
8. If you strip a practice of ancillary services you should not complain when it starts losing money.
9. Offering a hospital's benefit package to physicians and their staff is a significant contributor to that red ink on the bottom line.
10. Primary care physicians are important, but put them on a pedestal and ignore the specialists at your own risk.
11. A practice only has value when you are buying it. When it's time to sell it back to the doctors it has little, if any, value.
12. Once you have a group of doctors really mad at you, it's hard to keep your job.

By the late 90s deals were falling apart right and left, and the finger pointing that went on was enough to make you think you were inside the Beltway. Administrators said physicians wouldn't work hard enough (but couldn't prove it because of the terrible hospital-system-generated data they'd collected). Physicians blamed administrators for mismanaging their practices, driving away their loyal staff, and telling them how to practice medicine. Hospital and practice staff pointed fingers at each another and cried "They're incompetent!" It was very messy.

What's different this time around?

Hospital administrators are smarter. So are physicians. So are consultants. No one wants to see history repeat itself. Organizations engaging in practice acquisition are going about it with realistic expectations and viable strategies.

What hasn't changed are motives for buying practices. The primary reason administrators cite when getting into the practice acquisition game is a desire to maintain a loyal and robust medical staff. Accustomed to working with long-range strategy, astute hospital leaders recognize the need for an active recruitment program and succession planning. If you're in a growing area or have a number of physicians nearing retirement age, the ability to recruit is essential. Having a viable group that new doctors can step into can make all the difference in attracting quality candidates – often younger physicians who have little interest in running their own show. As a hospital, it's likely that you have pockets deep enough to offer first- and second-year salary guarantees for the right recruits. Other reasons to own practices include the ability to respond to competitive pressures, grow in strategic specialties and protect market share.

If you think getting back in the physician acquisition game might be a good strategy now, consider the following (see www.DeltaHealthCare.com for a full explanation of each).

1. **Understand what motivates a physician to consider selling a practice.**
2. **Do an evaluation, not just a valuation.**
3. **Structure a compensation plan that keeps the doctors happy, productive, and efficient.**
4. **Flexibility is a sign of strength, not weakness.**
5. **Get the right management in place and then let them manage.**
6. **Don't mess with the billing system.**
7. **Plan ahead to avoid cash flow problems.**
8. **Expect overhead to increase.**
9. **Mentor new physicians.**
10. **If things get rocky, don't immediately bail out.**

Just like Amazon, eBay and Google, there are hospital leaders who have figured out how to own and manage practices. They've learned from past mistakes, are determined not to repeat them, and take the long view. You can be successful in pulling together a network of physicians if you are so inclined. Be realistic, plan well, execute even better, and you'll enjoy a solid relationship with loyal doctors.

QUESTIONS, ISSUES OR COMMENTS?

Contact Delta's highly experienced consultants at **800-467-3310** or email:

Daryl Demonbreun, dd@deltahealthcare.com

Randy Bauman, rb@deltahealthcare.com

Leif Beck, J.D, CHBC, leifbeck@deltahealthcare.com

Angela Herron, aherron@deltahealthcare.com