

## The Hospital Perspective: Stronger Bonds through Joint Ventures

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Like many of hospitals around the country, our non-profit, community hospital has watched intently as outpatient surgery centers have proliferated. We have noted the increasing interest of surgeons in owning these facilities, and the high rates of patient satisfaction they deliver. Not surprisingly, the prospect of losing high-revenue cases to local surgery centers was of great concern to our executive team.

But, based on the experience of our hospital in developing Turk’s Head Surgery Center in West Chester, Pennsylvania as a joint-venture (JV) in partnership with a group of local surgeons, I believe hospitals can benefit from involvement with outpatient surgery centers. Further, hospitals that commit to work in true partnership with surgeons stand to realize significant value that goes far beyond financial measures.

I should be clear on a few key points, however. Firstly, developing and managing a successful surgery center business can be difficult. There are many risks to navigate and a great deal of work to be done.

Secondly, while clinical excellence and a quality patient experience are central goals of both types of endeavors, managing a successful outpatient surgery center requires different skill sets and knowledge than running a successful hospital.

***Hospitals that work in true partnership with surgeons can realize significant value.***

Though Turk’s Head had great clinical outcomes and high patient satisfaction from day one, the business got off to a bumpy start. Recently, we’ve turned things around, and the keys to our success have been:

- Clearly understanding both the risks and opportunities in building the business
- Recognizing the considerable non-financial gains
- Properly aligning incentives, and
- Engaging a management partner with the skills and commitment to help the business succeed.

### Seeing the Big Picture

It’s only natural that hospitals – especially non-profit hospitals operating on razor-thin margins – are somewhat suspicious of the development of outpatient surgery centers. Reimbursement dollars will be lost as profitable “bread and butter” cases migrate to outpatient facilities.

But, it’s dangerous for hospitals to view outpatient facilities (and the surgeons who want to develop them) as the enemy. If they do, they risk losing out entirely on an important and inevitable evolution in the industry, not to mention several strategic opportunities. Standing on the sidelines would have been a mistake for our hospital. We knew outpatient centers would be coming to our area and so we focused on building the best business we could with surgeons who were important to us.

But hospitals must strike a delicate balance in that they can’t place too many stipulations and conditions on their involvement in JVs or seek to dominate partnership arrangements. That can lead to damaged relationships with surgeons, instead of stronger relationships.

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### Strategic Considerations

When doctors on our staff first approached us with their proposal, hospital leadership had mixed feelings. We balanced the projected revenue loss with the full range of potential gains, including intangible, non-financial benefits, such as:

- Stronger relationships with the current staff
- The opportunity to offer young surgeons a compelling investment opportunity – a high-impact recruiting chip
- Reduced pressure on ORs, which were very near full capacity
- More time and flexibility to pursue necessary expansion plans, including the development of a cardiac center of excellence.

These were all important strategic considerations for us, though other hospitals may also benefit from “branding” new centers, expanding their geographical presence and associating themselves with an advanced, leading-edge facility.

There were financial considerations, too, of course. For instance, we developed the center on property we already owned, enabling us to expand capacity without adding large-scale capital expenses directly on our balance sheet. Further, we expected the new center to be profitable, which, along with expanded capacity in other specialties, would replace a large portion of revenue we stood to lose. This wasn’t a zero-sum game, in other words.

In the end, we recognized that we didn’t have to own a huge stake to make the business work. Most hospital’s finances dwarf those of surgery centers; therefore, hospitals don’t necessarily need majority ownership stakes. We held a 20% stake in Turk’s Head initially, and hold an even smaller percentage today. That may sound like a small piece, but it was more important to us to work alongside the surgeons in this venture. Yes, we stood to lose revenue, but it wasn’t just about the money.

### Aligning Incentives, Managing Variables

Once we decided to move forward, it became a matter of structuring the business around the right mix of incentives for us and our surgeon partners, and managing the huge number of variables required for success. We took into account the ancillary income opportunities for surgeons, and their desire to feel empowered and in control of their work environments. We factored in our wish to have a seat at the table. All of these are reflected in the business model.

As I said, the project got off to a bumpy start. Some of the surgery center’s initial business decisions led to a few strategic and tactical mistakes. As a result, the center’s finances suffered out of the gate, though patients loved being treated there. The partners eventually decided to engage Blue Chip in mid-2008 to help improve performance, and the results were immediate.

### Partners vs. Consultants

Initially, the center hired a fee-only consultant to help manage the business, but having an equity-holding partner has been a more productive arrangement. Now, we have a partner who not only provides a full range of services necessary to run the business (including billing and claims management, contract negotiation, and staffing support), but is also fully invested in our success.

The center interviewed a number of potential management companies, but Blue Chip was a good fit on several levels. They knew our payer and clinical environment, having developed successful surgery centers in a community nearby. Their people had a practical and realistic business plan. Their pro formas have proven to be very accurate, especially compared to initial feasibility studies, which were excessively optimistic in terms of both case volumes and reimbursement rates. Their benchmarking data around staffing ratios, supply and drug costs were also very useful.

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Blue Chip's approach makes sense, too. They handle the business concerns and keep all partners in the loop. Meanwhile, the doctors are free to focus on the patients and the hospital leadership can stick to its top agenda items. Frankly, we didn't choose the partner offering the highest financial upside, but Blue Chip was the most transparent and the most willing to link their compensation to the bottom-line success of the business.

For all those reasons, hospital leadership felt confident in entering into a very creative JV agreement with the doctors' group and Blue Chip, in which we significantly reduced our ownership stake. Now that may seem counterintuitive, especially when we've lost cases. But, again, this surgery center isn't a strictly financial proposition. We are still involved and hold a seat on the board.

The point is, owning a major stake and exerting control are not necessary for hospitals to benefit from outpatient surgery center projects. Improved relationships and expansion of our surgical staff will ultimately benefit the hospital and the community.

## The Bottom Line: Getting to Win-Win

After a bumpy financial beginning, the surgery center is operating well at all levels. Patient satisfaction is high, the clinical outcomes are very good, and profitability has been achieved. The hospital made some financial sacrifices to make this business work, but maintaining healthy relationships with our surgeons is critical to our long-term success, even if the value of those relationships can't always be quantified as line items on a balance sheet.

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