

diagnostic

The Fate of Physician-Owned Orthopedic ASCs: Independence or Integration?

Increased demand for higher quality, lower costs, and more coordinated care is driving provider consolidation across the country.

KEY TAKEAWAYS:

- Major market trends such as the push toward value-based payment, the increasing costs associated with healthcare reform, and the existing gap between freestanding and hospital-based outpatient reimbursement will continue to drive greater alignment between health systems and ambulatory surgery centers.
- Independent physician-owned ASCs can no longer rely on historical out-of-network (OON) strategies and must offer a high-quality, low cost alternative to health systems or seek innovative opportunities with aligned health systems.
- If health systems and physicians choose integration, they will need to collaborate to provide new value to patients by providing comprehensive, coordinated health services across the continuum.

The pace and scale of change vary substantially across markets, creating uncertainty regarding the fate of independent physician-owned ambulatory surgery centers (ASCs). Regardless of specific market conditions, ASC owners are closely monitoring the progress of reform and considering a variety of transactions, including the sale of their ASC. Concurrently, health systems operating in markets with independent ASCs may find the ASC model attractive due to generally low costs and a high level of efficiency. Because of the continuing uncertainty about future changes to reimbursement and costs for outpatient orthopedic surgeries, the number of health system/ASC transactions is likely to increase over the next few years.

This *Diagnostic* outlines major trends related to orthopedic ASCs and identifies strategies for addressing healthcare reform from the perspective of both orthopedic ASC owners and health system executives.

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- Should physician-owned ASCs seek to maintain their independence, or would they be better off joining a major health system or ASC management company? If they choose to remain independent, what strategies should they pursue to remain viable?

- Should health system executives seek to acquire or partner with independent ASCs to gain market share and enhance reform readiness? If so, how?

This *Diagnostic* focuses on orthopedic-related ASCs; however, the fundamental principles can be applied to other specialty-driven ASCs.

Major Market Trends

Four major market trends are currently impacting the market for orthopedic ASCs:

- **Increasing Volume**—The market for orthopedic ASC services is growing due to the amount and complexity of cases that are being performed in an outpatient setting, as well as because of changes to payor policies that are aligning reimbursement with this shift. For example, commercial payors are driving new orthopedic volume from hospitals to ASCs by providing reimbursement for total knee replacements and some total hip replacements in the ASC setting. Also, ASC reimbursement policy changes, such as the growth in Medicare allowed charges per beneficiary, have created added flexibility for the type and complexity of orthopedic services provided in ASCs.
- **Flattening Reimbursement/Rising Costs**—Although orthopedic ASCs still enjoy relatively favorable reimbursement compared to other outpatient surgical specialties, they will experience downward pressure on reimbursement from both government and commercial payors. Further, commercial insurers are increasingly moving toward narrow networks, which could pose financial challenges for orthopedic ASCs that are currently relying on OON strategies. ASCs must fully understand the implications of changes in reimbursement that might occur as CMS focuses on the rate differential inherent in facility fees. ASCs are also facing more stringent Medicare documentation requirements, leading to increased denials and longer A/R cycles. Meanwhile, costs continue to rise.
- **Market Saturation**—The ASC market experienced significant growth from 2000 to 2010 (especially in markets lacking Certificate of Need restrictions), although it has flattened in the last few years. With nearly 6,000 freestanding ASCs in the country, composed mostly of smaller independent operators, a significant opportunity exists for consolidation. As larger health systems acquire physician-owned ASCs, competition for referrals will increase as these systems strive to keep their patients within their network.

- **Reform Uncertainty**—The Affordable Care Act (ACA) is aimed at driving improvements in the quality of care and lowering the cost of care, often through care coordination and population health management, to drive value. While markets vary significantly, the infrastructure and tools needed to implement a value-based, coordinated model are often not available or financially viable for independent ASCs. On the other hand, the low-cost environment of ASCs makes them attractive in the reform environment, especially relative to hospital operating rooms (ORs).

The ASC Owner Perspective

There are a number of factors critical to determining the future viability of independent, physician-owned orthopedic ASCs. From the perspective of ASC owners, the choices are complicated and include:

- Maintaining 100% independence.
- Selling a minority stake (potentially to a management company) and gaining management expertise.
- Selling a majority stake (potentially to a hospital or health system) and losing control.

In addition to historical profitability, well-positioned ASCs are characterized by a number of key factors that will drive success and likely influence the decision to sell a minority or majority stake:

- **Diversity of the Physician and Procedure Mix**—ASCs with a diverse and busy physician base provide a mix of high- and low-volume services and a larger service offering, strengthening their ability to respond to reimbursement uncertainty. Further, buyers will be wary of acquiring centers with many physicians approaching retirement. To succeed independently and increase their value, ASCs should consider offering complementary services and developing the capabilities to support new orthopedic procedures. ASCs may consider adding specialists in pain management, urology, and gastroenterology, among others, that complement the existing resources and infrastructure of the ASC and can increase utilization.
- **Managerial Sophistication and Efficiency of the ASC**—Independent ASC owners should benchmark their expenses and revenues to determine their relative efficiency. Underperforming ASCs may be strong candidates for selling a minority share to ASC management companies to improve efficiency and lower costs. Further, such an analysis will enable owners

to evaluate the profitability of their procedure mix and focus on the most profitable cases.

- *Participation in Contracting Initiatives* – ASCs should develop a thorough understanding of contracting initiatives being pursued in the market by competing centers and health systems. The low-cost environment may provide an opportunity to participate in a narrow network or bundled payment initiative in partnership with a health system that will potentially improve physician referrals and increase volumes (but at the expense of lowering profitability per case). Conversely, ASCs in a position to drive value in a competitive environment may find themselves in a bidding war if they elect to sell a majority stake to a health system. Health systems place a premium value both on their relationships with surgeons and their ability to prepare for the low-cost environment that will be necessary in the era of healthcare reform.
- *Dependence on OON Revenues* – A lot of ASCs have become immensely profitable through OON revenues, but many industry experts feel that these revenues will decline in the future. Therefore, potential buyers are likely to discount the purchase price of any ASC that is highly dependent upon OON revenues; as such, ASCs will need to seek efficiencies to counterbalance the decrease in this type of revenue.
- *Ability to Focus on Patient Satisfaction, Quality, and Outcome Reporting* – The healthcare system is becoming more consumer-oriented as costs shift away from employers to individuals. As more consumers price-shop, it will be critical for centers to be able to demonstrate the advantages of the ASC model and illustrate favorable outcomes relative to competitors. Payor pay-for-performance programs further increase the importance of this issue.

The Health System Executive Perspective

Health systems are increasingly partnering with or purchasing ASCs. From the perspective of health system executives, the future choices are no less complicated than they are for ASC owners:

- Continue to compete with ASC owners.
- Partner with an independent ASC, potentially through an ACO or narrow network.
- Purchase an ASC.

For a health system executive, the choices above will be influenced by a number of factors, including:

- *Progress in Building a Continuum of Care* – New reimbursement models will focus on increased efficiency and the ability to manage the health of a population. Health systems in markets that are moving aggressively toward accountable care structures may find the prospect of ASC ownership attractive. ASCs could play a key role in developing a low-cost, high-quality care delivery model focused on preventive care and outpatient services. Controlling such a care continuum will help position health systems for value-based payments.
- *Opportunity to Capitalize on HOPD Rates* – Health systems with a high volume of government patients will be able to immediately derive enhanced reimbursement from ASCs due to the systems' ability to seek Medicare reimbursement at 100% of HOPD rates (physician-owned ASCs are generally reimbursed for Medicare at approximately 56% of HOPD rates). However, the differential may be short-lived because a recent Medicare Payment Advisory Committee (MedPAC) report to Congress encourages further study of ending the payment differential between hospital-owned and independent ASCs.¹
- *Physician Relationships* – Hospitals with strong orthopedic surgeon relationships will likely find more success in partnering with or purchasing orthopedic ASCs. To build these relationships, hospitals may pursue models that serve as stepping-stones to an ASC partnership, including clinical comanagement agreements and bundled payment initiatives. It is important for healthcare system executives to fully understand the referral patterns to their independent orthopedic affiliates. In many instances, the employed primary care network of health systems makes up 80% to 90% of the referrals to independent specialists. Under this scenario, the health system may have leverage to keep the care of the patient base within the network while maintaining high quality, low cost, and the flow of health information.
- *Specialty-Focused Employed Physician Networks* – Physicians selling their ASC stake will be likely facing a declining income stream and may be interested in combining the sale of the ASC with employment (if it includes a favorable compensation package). Health systems operating strong employed networks with efficient operations and specialty focus will be attractive to surgeons. Surgeons can be wary of joining primary care-dominated employed networks and may seek opportunities elsewhere if the specialty focus and expertise are minimal.

¹ MedPAC Report to the Congress: Medicare Payment Policy, March 2013.

Decision Matrix

The following matrix provides a framework to evaluate options pertaining to freestanding ASCs:

	Divest/Purchase or Joint Venture	Do Nothing
Physician-Owned Freestanding ASC	<ul style="list-style-type: none">• High-cost environment.• Difficulty recruiting new investors. Increasing presence of narrow networks/ACOs and employment of primary care physicians by local health systems.• Margins reliant upon OON strategy.• Market saturation of ASCs and independent orthopedic physician groups.	<ul style="list-style-type: none">• Strong management expertise and low-cost environment.• Ability to recruit new investors.• Favorable reimbursement environment.• Aligned primary care network.
Healthcare System	<ul style="list-style-type: none">• There is a need for a low-cost, outpatient surgery facility to meet ACO/narrow network requirements.• There is insufficient capacity in the outpatient OR.• Little to no alignment exists between the health system and the orthopedic surgeons providing care at its facilities.• Orthopedic surgeons are reliant upon ancillary revenue but are not willing to become employed.	<ul style="list-style-type: none">• A large percentage of the primary care base is employed by the health system.• The health system employs most of the orthopedic surgeons providing care at its facilities.• The health system has outpatient OR capacity.

Conclusion

The future viability of an independent orthopedic ASC depends on its ability to offer new value to patients, whether by providing a high-quality, low-cost alternative to health systems or by integrating with a health system to provide patients with access to comprehensive, coordinated care for all aspects of their health. Now is the time for ASC investors and health system leaders to evaluate their market in the context of healthcare reform to determine whether to pursue a strategy of independence or integration. If independence is chosen, ASCs and health systems will need to seek partnership opportunities and consider innovative contracting initiatives while simultaneously managing operational and financial performance. If integration is chosen, ASCs and health systems will need to focus on increasing value to patients by providing comprehensive, coordinated health services across the continuum.



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