

# Trustee Insights

EMERGING ISSUES



## Understanding Your Physician Employment Strategy

Adopt three best practices to help your physician network succeed in an evolving health care sector

BY DAVID W. MILLER

**N**ationally, more than half of physicians are employed by a hospital, health system or large provider group. As the number of employed physicians grows, it creates new challenges for boards and a renewed urgency to understand this trend and its implications.

One major factor in the growth of physician employment is the desire of newly minted physicians: Residents finishing their training are generally looking for employment

opportunities. Those opportunities offer guaranteed income and a controllable practice lifestyle.

Another factor driving this trend is the hospitals themselves. In a shifting market, one way to guarantee patient access is physician employment. Without this access and the available physician expertise, the ability of the hospital to provide high-quality care and enhance continuity of care can be challenged. The shortage of physicians in select specialties has also



### TRUSTEE TALKING POINTS

- More than half of physicians in the U.S. are employed by a hospital, health system or large provider group.
- The number of employed physicians continues to grow, creating new challenges for boards.
- An employment strategy can strengthen relationships with physicians for better outcomes.
- Boards must oversee and direct the employment process to ensure its strategic value.

fueled this trend.

One other factor is the growing complexity of managing physician practices. Requirements for greater

investment in electronic health records, as well as for tying performance metrics to reimbursement, create management challenges for small practices. This reality is making it difficult for them to be successful.

## Implications of This Trend

Five key issues have proven significant to boards whose organizations are choosing to grow their employed physician networks:

**Strategic oversight.** How this group of clinicians integrates with the overall organization, how it supports the organization's strategy and quality agendas, how it supports the population health effort — all are matters organizations are struggling to address.

**Financial performance.** The losses created by employed physician networks are a challenge, with boards focusing on how to ensure the networks are financially sustainable.

**Compliance.** Given the laws governing relationships between hospitals and physicians and the significant risks those relationships create, close monitoring by the board is required. Two concerns are particularly relevant: physician compensation and the acquisition of physician practices.

**Management talent.** Large-scale employment will result in new senior executives being added to the hospital's management team — a significant but necessary expense. The ability of hospital leaders to assess the capabilities of potential hires is a challenge as well.

**The medical staff dynamic created by physician employment.** There are additional challenges in

balancing private practitioner interests with those of the employed group (e.g., organizational loyalty and care coordination). These matters must be addressed as the hospital or system works to achieve its mission.

## Examples of Boards Taking Action

Our firm has helped many organizational boards acquire a solid understanding of the employment dynamics. Below are three cases, all driven by board action, that made a strong impression on members of our team.

### Case 1

A seven-hospital system, anchored by a major tertiary hospital, had pursued employment of more than 250 physicians. Losses from this pursuit were \$44 million, and the board had approved every transaction. The system's overall financial health was solid, despite the employment losses. However, the board was anxious and had lost track of the rationale for employment. In essence, they could not see the forest for the trees.

With our assistance, system executives focused on two issues to educate the board:

- The strategic rationale for each employment decision by specialty. Those decisions generally related to service line growth, emergency department coverage, community service and patient access.

- A focus on losses and how they compared to benchmarks. This assessment gave the board some confidence, as the losses were on average lower than benchmark. It also led to useful discussions in

specialties where the losses had exceeded benchmarks.

A final step in the deliberation related to compliance. The chief counsel developed board resolutions reaffirming the board's support for each employment decision. If challenged on those decisions, the hospital could document that the community board supported employment.

The key lessons of this case are twofold for your board. First, it is important to understand the strategic rationale behind the employment of physicians. If the decisions make sense from that perspective, it is also important to understand how the employed network stacks up on key performance indicators. Each of these insights creates accountability for management.

### Case 2

A large tertiary hospital had employed approximately 200 physicians at losses of \$60 million annually. However, management was not being transparent about the situation. A board member noted the losses in the audit report and began to ask questions. Corrective actions followed.

Some boards halt the expansion of the employed network when faced with similar shocks. This is generally a bad decision in our view, as it may undercut the organization's ability to pursue its strategic objectives. In this case, however, the trustees put the brakes on the process for only a brief time, to their credit, so the hospital suffered no long-term damage.

The second case focuses on the importance of board members asking questions and probing to

better understand the performance of the network. If your management team is not sharing this information, ask.

### Case 3

A four-hospital system built a 375-member physician network whose leaders had begun to pursue strategies independent of the health system.

This issue generally falls to the CEO to resolve, but the incumbent CEO did not act. The board became aware of the disconnect around the time the incumbent was retiring. Addressing that disconnect was a major element in the selection of the new leader.

The final case highlights two important matters for the board: understanding the leader's vision for how to integrate the physician network in the system or hospital strategy, and how to hold the CEO accountable.

## The Board's Role

For most veteran board members, the employment of physicians represents a learning experience. Oversight of the physician network is a new and evolving role for trustees. The board should play a role related to the five key issues noted above:

**Strategic rationale.** The first role of the board is to ensure the employed physician network's strategy complements the strategy of the health system or hospital. This matter requires an understanding of the strategic rationale for the employment decisions. It also requires an understanding of the organization's long-term objective, which should

be building a physician group that can manage risk. Building such a group will require significant management talent (addressed in greater detail below). Strategy is an issue that the full board should understand, with leadership from a Strategic Planning Committee, if one exists.

The strategic intent of physician employment falls into several categories:

- The organization needs to ensure it has the capabilities needed to implement the strategy. One of our clients pursued employment of a large cardiology group to support the hospital's cardiovascular growth strategy. The hospital was willing to make investments in new physicians and new geographies that a private group would not.
- A second strategic need is community health improvement. This intent can relate to both building clinical capabilities and ensuring patient access to care. Each can contribute to greater continuity of care.
- Employment as a physician retention strategy is another need. The desirability of retention may relate to access, strategy, community health and safety, as physicians are not stretched beyond their capabilities. It may also encompass succession planning, where the retention goal relates to a practice rather than to an individual physician.
- Finally, the organization needs to build the capability to manage risk and/or manage the health of a population. Employment can serve to ensure the right mix of physicians, ensure the high quality of physicians, and enhance the clinical capabilities of the organization.

**Financial performance.** A second role for trustees relates to financial sustainability. The board's fiduciary role extends to the employed network, and our firm has seen more than one hospital brought to its knees by enormous subsidies of physician networks. The Finance Committee should have primary responsibility for this issue.

Several factors can drive practice losses, and understanding their genesis can help the board and management decide how to improve performance. These factors include:

- Hospitals invest more resources in the practices than physicians would if they owned the business. A prime example of that is information technology.
- Misalignment of physician compensation and productivity, either through poorly designed compensation systems or through intentional policy. Redesigning compensation plans can mitigate some of these losses.
- Low provider productivity. This factor often relates to inability to control the physician schedule, and can be fixed with scheduling templates and greater control by the front-office staff over scheduling.
- Low staff productivity. Most hospitals have sophisticated systems to measure hospital productivity, and need to build analogous systems for the practices.

Many small- to medium-sized hospitals run into another problem: Three physicians may be needed to ensure "reasonable" call schedules, and therefore physician retention, when there is only enough business to support two physicians. Other than sharing physicians with other hospitals or increasing the staff of

advanced practitioners, not much can be done about this challenge.

Oversight of practice losses compared to benchmarks is a key first step for the board. In most cases, comparing losses to benchmarks is a better approach than worrying about the fact that there are losses.

A second concern for the Finance Committee is understanding how the subsidies in the network fit into the overall financial performance of the organization. Understanding how the practice losses fit into the general financial health of a service line is critical for a board. In the case related to the acquisition of the cardiology group noted above, the board received reports on the financial status of the cardiovascular service line. This gave the board insights into the role the growing practice losses played in the service line's growing value to the hospital.

**Compliance.** A third role, often overseen by a Compliance or Transaction Committee of the board, is compliance with various regulations and prohibitions related to physician transactions. These requirements are complex and create counter-incentives. That said, with hospitals risking significant fines for noncompliance, board oversight is required. Your counsel can best coach you through this quagmire.

**Management talent.** The board should require the CEO to review the management infrastructure and capabilities of the physician network leaders. Is the leader capable of managing the group? Is the management infrastructure adequate for the group? What norms is the CEO using to make that judgment? For what results is the group management

## TRUSTEE TAKEAWAYS

For a physician employment strategy to be rational, strategically valuable and economically sustainable, the board should make sure that:

- **It understands and supports the employment strategy and its long-term objectives.**
- **It understands the financial losses, their origins and their strategic value.**
- **The management team is building a plan to contain those losses.**
- **Individual relationships with physicians do not create compliance issues.**

team accountable, and how are they performing? Most boards would benefit from making this an explicit discussion.

**Medical staff dynamics.** This key issue is a difficult area for the board, as much of it is embedded in medical staff politics. Questions to the CEO and chief medical officer around problem areas and actions by the employed network to work with private physicians will increase the board's understanding of the opportunities and risks. The board should know that the management team is thinking about these challenges and addressing them to the degree feasible.

### Best Board Practices

How can your board learn about and manage this new set of requirements? From our observations,

there are three best practices your board should adopt, which are all an outgrowth of prior discussions:

- Ensure the board understands and supports the employment strategy. Many boards have lost sight of the strategy that led them to commit to employment. Many more have not focused on the strategy's long-term objectives.
- Work to understand the financial losses, their origins and their strategic value. Then ensure that management is building a plan to contain those losses. The Finance Committee should review network performance compared to benchmarks.
- Also ensure that individual relationships with physicians do not create compliance issues. This practice means understanding the fair market value and commercial reasonableness of each employment deal and working through the Compliance or Transactions Committee of the board.

These practices will help guarantee that your organization's employment strategy is rational, strategically valuable, and economically sustainable. As the health care market continues to evolve, and the drive to produce better outcomes at predictable costs grows, it is hard to imagine how that can happen without tight relationships with physicians.

Employment offers a great option to develop those tight relationships. However, it can only work if the board provides appropriate oversight and direction to the process.

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