# Co-Management Arrangements A Focus on How Payments Work and are Valued

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## Service Line Co-Management Relationships

- **Purpose:** Recognize and appropriately reward participants for developing, managing and improving the quality and efficiency of a particular hospital service line
- **Scope:** May cover inpatient, outpatient, ancillary and/or multi-site services
- **Participants:** May include one or more physicians, medical groups or faculty practice plans, or a joint-venture entity owned in part or entirely by participating physicians or medical groups

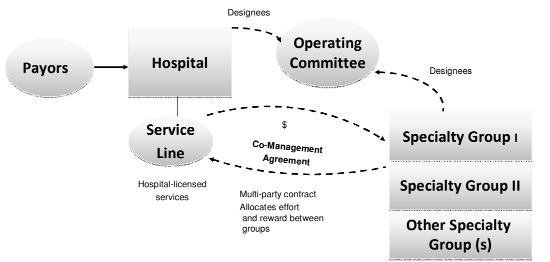


## Service Line Co-Management Arrangements

**Example: Potential Scope of Cardiology Service Line**

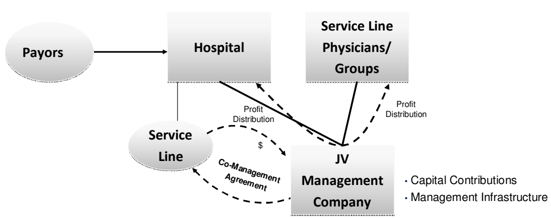
- Open Heart Surgery
- Cath Lab
- Echocardiography
- Vascular Surgery
- Invasive Radiology
- Inpatient Cardiac & Vascular
- ECG
- Cardiac Rehabilitation

# Direct Contract Model






# Joint Venture Model






# Service Line Co-Management Arrangements

- Typically two levels of payment under the Co-Management Arrangement:
- **Base Fee:** A fixed annual base fee that is consistent with the FMV of the time and efforts of the participating physicians
  - Includes compensation for service line development, management and oversight
- **Bonus Fee:** A series of predetermined payments that are contingent on the achievement of specified, mutually agreed upon targets
  - Targets must be objectively measurable and based on program development, quality improvement and efficiency.
- Must be fixed, fair market value arrangement; independent appraisal strongly advised

## Service Line Co-Management Arrangements

### Examples of Co-Management Services

- Development of Service Line
- Medical Director services
- Budget process
- Strategic/business planning process
- Community relations and education
- Patient, physician and staff satisfaction surveys
- Development of clinical protocols and performance standards



## Service Line Co-Management Arrangements

### Examples of Co-Management Services

- Ongoing assessment of clinical environment and work flow processes
- Physician staffing
- Patient scheduling
- Staff scheduling and supervision
- Human resource management



## Service Line Co-Management Arrangements

### Examples of Co-Management Services

- Case management activities (*e.g.*, discharge planning, arranging follow-up services and supplies, call back processes)
- Materials management
- Medical staff-related activities and committee participation
- Credentialing assistance
- Coordination with and reporting to hospital
- Intensity of service: do, assist, or advise

## Typical Features of a Co-Management Arrangement

- Compensation for the manager's services is typically comprised of a **base fee** and an **incentive fee**.
  - However, for small service lines and/or in unique instances when the services are very limited in scope (*e.g.*, sleep labs, wound care centers), there may only be a base fee.
- The co-management arrangement may or may not involve the creation of a new entity (*i.e.*, a JV, which may or may not be owned in part by the hospital).
  - Thus, the "manager" may consist of the physicians only, or the physicians and the hospital within the framework of a joint venture.
- The co-management agreement will require replacement or redefinition of existing medical director agreements to accommodate the services provided by the managers. Notwithstanding, all medical directors must be paid from the **base fee** management fee.



## Typical Features of a Co-Management Arrangement

- The agreement stipulates a listing of core management / administrative services to be provided by the manager (for which the base fee is paid).
- The agreement includes pre-identified incentive metrics coupled with calculations/weightings to allow computation of an incentive payment (which can be partially or fully earned).
  - Usually tiered in terms of level of accomplishment and associated payouts
  - Must demonstrate some level of improvement over "current state" in order to receive the "top tier" of compensation.
  - Can provide some level of compensation for maintaining current state, if at national benchmark or better.
- Compensation is directed towards accomplishments rather than hourly-based services.



## Valuation Process – Riskiness of Co-Management Arrangements

- Among the spectrum of healthcare compensation arrangements, certain co-management arrangements have traditionally been viewed as having a relatively "high" degree of regulatory risk if FMV and commercial reasonableness cannot be demonstrated.
  - By design, these agreements exist between hospitals and physicians who refer patients to the hospital.
  - Application of traditional valuation methodologies has been limited and less objective as compared to other compensation arrangements.
  - In most cases, physicians are not being compensated under the traditional "hours worked and logged" approach.
  - The "effective" hourly rate paid to physicians may be higher than rates which would be considered FMV for hourly-based arrangements (since a significant component of compensation is at risk).

## Valuation Process Approaches to Value

- Available valuation approaches include:
  - Cost Approach
  - Market Approach
  - Income Approach
- In considering these valuation approaches, an income approach can likely be eliminated since the possible or expected benefits of the co-management agreement **may not** translate directly into measurable income.



## The Cost Approach

- The Cost Approach can be used to estimate the "replacement" or "replication" cost of the management/administrative services to be provided by the manager.
- Very difficult, if not impossible, to accurately determine the specific costs involved in managing a service line.
- An analysis by "proxy," or an approach that estimates the number of medical director hours required to manage the service line in the absence of a management arrangement, (which is then multiplied by an FMV hourly rate) yields one indication of value.
  - However, within the framework of a joint venture management company, this approach does not consider the hospital's contribution.
  - Further, a key ideal of most co-management arrangements is to reward **results** rather than time-based efforts.



## The Market Approach

- The Market Approach recognizes that that there are certain management / administrative requirements associated with every service line management arrangement.
- However, it is also understood that each co-management arrangement is unique and may include and prioritize different market and operational factors.
- Therefore, within the framework of the Market Approach analysis, consideration must be given to the required management tasks.
  - Specific tasks and responsibilities of the managers must be identified.
  - On an item-by-item basis, the relative worth of each task/responsibility is "scored" relative to other comparable arrangements.
  - An indication of value of the management services is then established by comparing the "scoring" of the subject agreement to other service arrangements in the marketplace.

## Valuation Synthesis

- The Cost and Market valuation methodologies should be reconciled to arrive at a final conclusion of value.
  - The Cost Approach may "underestimate" the value of the arrangement because in the case of joint ventures, the Cost Approach only considers physician participation (*i.e.*, medical directors),
  - The Market Approach may "overestimate" the value of the arrangement because market comparables may not be exact.
- While it may be appropriate to give equal weighting to the two approaches, the valuator may conclude that one method should be weighted more heavily than the other.
- Once the FMV of the **total management fee** is established, an assessment must be made regarding the split between the **base fee** and **incentive fee** components.
- The FMV of the base fee must encompass payment of any medical director fees or administrative services related to managing the service line.



## What Drives Value?

- As a percentage of the service line net revenues, the **total fee** payable under a co-management arrangement typically ranges from 2% to 4.5% (on a calculated basis).
- The fee is fixed as a flat dollar amount, including both base and incentive components, for a period of at least one year.
  - Commonly, the base fee equals 50-70% of the total fee.
- The extent and nature of the services drive their value. Thus, the valuation assessment is the same whether the manager consists of only physicians or physicians and hospital management.
- Determinants of value include:
  - What is the scope of the hospital service line being managed?
  - How complex is the service line? (*e.g.*, a cardiovascular service line is relatively more complex than an endoscopy service line)
  - How extensive are the duties being provided under the co-management arrangement?
  - How many physical locations are being managed?



## What Drives Value?

- Size adjustments based on service line revenue:
  - Large programs may be subject to an "economies of scale" discount.
  - Small programs may be subject to a "minimum fee" premium.
- Consider the appropriateness of the selected incentive metrics:
  - Is the establishment of the incentive compensation reasonably objective?
  - Consider the split of base compensation and incentive compensation.
- Occasionally, certain other services (*e.g.*, call coverage) may be included among the co-management duties. (Some hospitals prefer to embed call coverage in the co-management fee to avoid a separate compensation arrangement with the physicians.)

## Possible Pitfalls of Co-Management Arrangements

- The service line/revenue stream to be managed must be defined objectively, and there should be no overlap between multiple service lines which may be subject to co-management arrangements (*e.g.*, surgery service line and orthopedic surgery service line).
- A co-management arrangement typically contemplates that no third-party manager is also providing similar services on behalf of the hospital or its service line.
- Care must be taken to ensure that employed physicians who are part of co-management arrangements are not double paid for their time.
  - Employment compensation based solely on wRVUs is self-normalizing.



## Possible Pitfalls of Co-Management Arrangements

- Medical director agreements related to the managed service line must be compensated through the base management fee.
- There can be no passive owners, active participation and significant time and effort are required by busy physicians.
  - Documentation requirements



## QUESTIONS?