what to look for when acquiring or partnering with ASCs

As many hospitals and health systems respond to the imperatives of value-based care by acquiring or partnering with physician-owned ambulatory surgery centers, the industry is seeing a reversal of what in many cases had been an adversarial relationship.

The U.S. healthcare system is undergoing a historical shift towards outpatient care. The reasons are complex, but they can be attributed primarily to a rapid confluence of clinical, political, demographic, and economic forces that are creating swift, industrywide change. Overall, outpatient volume has been projected to increase by nearly 20 percent during the next decade.a

The migration toward ambulatory care is in many ways a natural progression: With the emergence of modern surgical techniques and anesthetics, even advanced procedures today can be performed safely in an outpatient setting. The use of noninvasive and minimally invasive procedures has helped reduce infection rates, with research showing that 4.84 out of 1,000 patients who undergo outpatient surgery develop a surgical site infection (SSI), compared with 8.95 out of 1,000 surgery patients across all settings.b

The increased focus on value-based care is another factor contributing to the increased focus on outpatient care. The industry is increasingly turning its attention to outpatient care as a lynchpin in efforts to upend decades of inefficiencies in U.S. care delivery practices, based on evidence that well-coordinated outpatient care is the most cost-effective option available (e.g., ASC procedures take about 32 minutes fewer to perform than those performed in a hospital).c

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With the move away from costly fee-for-service care, by 2018, 50 percent of all Medicare payments are expected to be value-based, up from 20 percent in 2014. When one considers these factors together, it becomes clear that developing outpatient services is a matter of survival for many hospitals and health systems in the new landscape, as they strive to keep down costly readmissions and maintain a high standard of care under bundled payment models.

An advantage for these organizations is that the business models and much of the outpatient infrastructure already exists; for hospitals and health systems, it’s typically a matter of acquiring and integrating already established businesses, not creating new clinical approaches or building entire organizations from the ground up.

Indeed, there already have been noteworthy instances of health systems partnering with or acquiring established outpatient providers. For example, Advocate Health Care recently announced it would acquire and operate healthcare clinics at 56 Walgreens drug store locations across greater Chicago—a deal that provides the largest health system in Illinois with increased patient volume, as well as a cost-effective setting for providing primary care and preventive services.

And less than a year earlier, Tenet Healthcare Corporation raised $2.2 billion to take over United Surgical Partners Inc., launching a joint venture with the outpatient provider that will include ownership stakes in 244 ambulatory surgery centers (ASCs), 16 surgical hospitals, and 20 imaging centers across nearly 30 states.

In publicly announcing these deals, company officials cited the changing market conditions alluded to previously: the transition to value-based care, the focus on patient choice and affordability, and increased outpatient volume. Although these developments are indicators of the U.S. healthcare industry’s ongoing evolution, the Tenet-USPI deal, in particular, is a sure sign of another wave of acquisitions to come within the once-sleepy outpatient surgery market. Because they provide a high-quality, low-cost, and convenient setting for performing an extensive array of sophisticated same-day procedures in a variety of specialties, the nation’s ASCs—numbering 5,260 as of 2013—continue to be strategic acquisition targets for hospitals and health systems.

It will be up to hospital and health system finance leaders to play a pivotal role in ensuring these ASC acquisitions and partnerships are successful. Informed by a clear understanding of the differences between hospitals and ASCs, these leaders will need to perform a due diligence process that involves assessing the appropriateness of the targeted outpatient facility and the reasons for targeting it. By understanding what to look for during the due-diligence process, finance leaders can mitigate the risks of a failed transaction and help their organizations capitalize on the very real opportunity ASCs provide in the era of value-based care.

**A New Opportunity for Collaboration**

Before undertaking a due-diligence process, finance leaders should have a clear understanding of the historical dynamics of the outpatient surgery marketplace. Since the very first ASC opened in 1970, hospitals and physician-owned surgical facilities have competed for the same patients, payment dollars, and talent, ultimately making it difficult for the facilities to coexist through the years. Hospital executives have long been concerned that physicians might be performing the lucrative surgical cases in surgeon-owned ASCs rather than in hospital outpatient departments (HOPDs). The flexibility, convenience, and entrepreneurial opportunities offered by ASC ownership can be attractive to

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physicians, especially for those frustrated by the challenges involved in scheduling hospital operating rooms (ORs).

Nonetheless, after years of strong growth, the ASC industry has recently shown signs of maturing. According to a 2015 report, growth in the ASC market fell abruptly to 4 percent in 2010-14 following a 13 percent growth rate between 2006 and 2009. Moreover, among ASC operators responding to a 2011 survey, more than half said they were considering closing underperforming centers, more than one-quarter said their facilities were losing volume, and nearly one-third attributed their financial troubles to competition from other ASCs and surgical facilities.

Hospitals recognized the opportunity, acquiring as many as a third of the ASCs that closed since 2009 and converting them into HOPDs, which are surgical facilities that are often indistinguishable from ASCs but that are owned outright by the hospitals rather than the physicians who perform procedures there.

There was a very good reason for hospitals to convert ASCs to HOPDs: The latter are paid at a much higher rate—at times, 50 percent more than ASCs receive for identical procedures. The exhibit below highlights some of the payment advantages HOPDs have enjoyed over ASCs. A rationale for this difference is related to the significantly higher fixed costs that a hospital incurs in operating an HOPD within its existing infrastructure compared with a freestanding ASC. Another reason for the payment disparity between HOPDs and ASCs involves how the Centers for Medicare & Medicaid Services (CMS) historically has adjusted these payments for inflation: When adjusting payment rates for ASCs, CMS applies the Consumer Price Index—Urban; for HOPDs, the agency uses the more

healthcare-specific Hospital Market Basket, a factor that historically has been higher than the CPI-U. Although it’s uncertain whether this payment differential will be resolved anytime soon, in a 2015 congressional budget deal, federal lawmakers did remove the direct incentive for hospitals to acquire off-campus ASCs outright and convert them into more-lucrative HOPDs. And more broadly, closing this payment loophole coincided with the historic shift toward outpatient care that continues to dominate health care today.

Practical Considerations: Operations

For many hospitals and health systems today, the potential clinical and financial benefits of partnering with an established ASC are simply too numerous to pass up. Nonetheless, as noted previously, there are key differences between hospitals and ASCs that should be considered during the due diligence process. The first involves managed care contracts—agreements between insurers and providers that establish the necessary volume for providers while limiting risk for the insurers through set contract payment rates for care delivered at “in-network” facilities.

In many cases, managed care contracts are the financial lifeblood of outpatient surgery centers and can have a significant impact on every aspect of the business. At the same time, poorly negotiated terms could mean financial disaster for facilities that are forced to accept cases that have no chance of turning a profit.

During the due-diligence process, a surgery center’s contracts, volume, ongoing and historic caseload, and all related costs for performing each procedure should be analyzed to determine the quality of these agreements. When targeting an ASC for an acquisition or partnership, hospitals should recognize some inherent

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h. The Advisory Board Company, How to Build ASC Referrals, 2015.
j. Nantz, J., “HOPD or ASC: 5 Questions for Hospitals to Consider,” Becker’s Hospital Review; March 10, 2015.
l. For further discussion of the payment differential between HOPDs and ASCs and the related recent Medicare policy developments, see Price, J., Buchsbaum, R., and Price, K., “Medicare’s Site-Neutral Payment: Impact on Hospital Outpatient Services,” hfma.org, November 2017.
differences in payment between HOPDs and ASCs, in addition to the payment differential cited previously. That is, although HOPDs frequently use ambulatory payment categories (APCs) to receive payments under managed care contracts, ASCs use a complex combination of CPT codes and percentage-billed arrangements.

Surgery-center coding is another critical area of difference between ASCs and HOPDs. For ASCs, surgeries are coded based on procedures, while for hospitals, they are line-item-based. ASCs also use the claim forms prescribed by the Centers for Medicare & Medicaid Services (CMS) for claims from physicians—CMS-1500 forms and uniform billing (UB) forms. In addition, there is no standardization of edit systems for ASC coding, with specific commercial carriers and Medicare using National Correct Coding Initiative (NCCI) edits but very little consistency in the industry otherwise. If a hospital does not understand these differences from hospitals claims and coding approaches, and handles these issues incorrectly, the result could be lower payments, denials, and compliance problems.

The dramatic difference in payment rates between the two also should be well understood. ASCs receive about 60 percent of the hospital payment rate for a similar procedure. Complex arrangements of “groupers” and percentage billed are used to determine payment amounts for outpatient surgery centers, while more traditional methodologies like per diem, case rates, revenue codes, and specific CPT® codes are used by hospital coding teams.

In addition, handling patient accounts in a surgery center requires quite a different approach and skillset than in a traditional hospital. While point-of-service (POS) collections have become more important than ever for all healthcare providers, outpatient surgery facilities, in particular, seem to be having the most difficulty in moving the needle on POS collections: 4.6 percent of all balances for outpatient procedures become bad debt, as compared with 2.8 percent of inpatient surgery. Therefore, it is critical to leverage the state-of-the-art technologies and processes designed for outpatient surgery centers to maximize POS collections.

Finally, it is critical that a surgery center has a strong accounts receivables management and appeals process in place. A 2011 U.S. Government Accountability Office (GAO) study showed that an aggregate of denial rates across three states ranged from 11 to 24 percent and were attributed to “a variety of reasons, frequently for billing errors, such as duplicate claims or missing information on the claim, and eligibility issues, such as services being provided before coverage was initiated, and less often for judgments about the appropriateness of a service.” The GAO report also indicated that for four of the six states where data were available, the success rates for appeals were between 39 and 59 percent.

The study showed that denials are falling into one of four primary areas: lack of precertification, failing to capture all procedures, inaccurate insurance information, and coding errors. As appeals are labor intensive and costly for outpatient surgery centers, preventative measures should be developed and refined based on recent and historic denial activity. Mechanisms for identifying denial trends that regularly impact surgery centers also should be put in place early on to avoid larger issues.

For a hospital or health system, success in the ASC market depends on the organization’s understanding of these operational nuances. These organizations’ billing departments often lack the skillset required for ASC coding and billing, which use different coding and contracting nomenclature to document and obtain payment for surgical procedures. Nonetheless, an organization may want to consider incorporating billing for an acquired ASC into its existing


n. GAO, Private Health Insurance: Data on Application and Coverage Denials, Report to the Secretary of Health and Human Services and the Secretary of Labor, March 2011.
patient financial services department, thereby making it possible to absorb the function with minimal FTE additions. In such instances, therefore, the due-diligence process should include an assessment of potential challenges regarding the feasibility of such an approach.

**Practical Considerations: Finances**

Balance sheet fundamentals pose a key potential pitfall for hospitals that acquire outpatient surgery centers: The only thing worse than acquiring the wrong type of center is discovering underlying financial deficiencies once the deal is signed. The following are key financial considerations to make when conducting due diligence on a potential outpatient surgery acquisition.

**Physician support.** In weighing this consideration, the acquiring organization should contemplate how many cases per month, by specialty, the ASC will need to take on to break even. It also is important to understand the current ownership structure and degree to which the organization can be assured of physician retention in key specialties after the deal is closed.

**Capital structure.** Hospitals should review an ASC’s ownership structure, as well as the alignment of financial incentives between the hospital and physicians. For example, is the ASC an independent facility owned by physicians? And does a management company have an ownership stake—and if so, how much?

**Facilities.** Not all leases are the same. A hospital should scrutinize the ASC’s lease obligations and understand its impact on an organization’s books. For example, how favorable are the terms of the current agreement? What will the options be in the future? And if the facility did need to relocate, how much would it cost, including downtime?

**Payment rates by payer.** Again, as an ASC, a facility likely will be paid at a lower rate than an HOPD. The acquiring or partnering hospital or health system should have a clear understanding of the ASC’s payment rate for every procedure performed in the facility. For example, are the existing contracts favorable? When do they expire? And, in the meantime, could they be renegotiated?

**Operating expenses.** For a typical multispecialty ASC, staffing costs make up about 24 percent of all expenses, medical and surgical expenses about 22 percent, and occupancy costs are about 8 percent, a 2013 study by VMG Health reports. The due diligence analysis should assess the extent to which the acquisition target matches up to these and other financial benchmarks.

**Incremental benefits.** Consideration should be given to any other advantages the ASC might offer a health system—for example, the extent to which it would allow the surgeries that constitute the organization’s current volume to be performed more cost-effectively and whether it will help in recruiting new physicians, preserving existing volumes, and retaining top-earning physicians.

**Primary care provider referrals.** The previously cited VMG study projects there will be a shortage of 31,000 primary care physicians in the United States by 2025. Meanwhile, physicians are accepting employment by health systems, forgoing private practice. Consideration should be given to the potential impact of the primary care physician shortage on the ASC’s volume.

**Patient satisfaction.** Health care is quickly turning into a retail business, and this new reality plays to the strengths of outpatient surgery. According to the Ambulatory Surgery Center Association (ASCA), 92 percent of patients are satisfied with the ASC care they receive, and out-of-pocket costs for procedures performed at an ASC can be significantly lower than at a hospital. ASCA data also show that the typical cost to patients for most outpatient procedures performed at a hospital is about double what it would be for the same procedure performed at an ASC. The due diligence process should delve into these and other

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community-specific factors that affect the patient experience and how the organization can best plan for them to ensure the acquisition will be successful and contribute to improved patient satisfaction.

The Benefit of Partnerships Versus Direct Competition

With the ASC to HOPD conversion incentive now gone, hospitals and ASC physician owners are realizing they have a greater potential for success today as co-owners of a joint venture ASC partnership than as direct competitors vying for the same patients in a given geographical region. ASC owners also are more open to ceding ownership to a hospital or health system and assuming a more purely leadership role within the acquired ASC.

A 2015 study noted more than half of health systems were at that time considering implementing an ASC acquisition strategy. And the reasons for such a strategy remain strong today. The 2015 study notes that hospitals and health systems viewed ASC acquisitions as effective means for gaining market share, expanding OR capacity, or performing surgery more cost effectively. All these goals remain attainable today, assuming hospitals and health systems dig deep during the due diligence process to understand how a potential ASC acquisition or partnership would fit into the hospital’s long-term strategic goals.

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