

Extending ASC Life Spans: Four Rules of Thumb for Mature Centers

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Beating the Actuarial Tables

A highly respected surgeon once told me, with absolute certainty, that it was impossible for any ambulatory surgery center (ASC) business to exist longer than a dozen years. While I disagree with this view, it is shared by many stakeholders in our industry, thanks to a combination of regulatory factors, demographics and a few ineffective management practices that have become standard operating procedure for many ASCs.

Why the 12-year lifespan? The theory goes like this: most ASC businesses are formed by groups of 8-12 surgeons in their primes (i.e., their 40s). Within a dozen or so years, most of the doctors begin thinking about retirement and cashing out their ownership stakes. But in that same time period, the fair market value of the center is likely to have soared – especially for successful ASCs. Thus, it becomes prohibitively expensive for new surgeons (presumably younger ones just launching their careers) to buy shares of the partnership. So, as the original investors retire, case volumes and revenue drop, and the business soon falls into a downward spiral that leads ultimately to the closing of the facility.

Even if new surgeons who can afford to buy the shares can be found, they may not necessarily be a good fit – clinically, temperamentally or in terms of their caseload – which can cause the business to suffer. Mega-centers with 20-30 partners face the same challenge, only on a larger scale; as they pass into their second decade of operations, they may find themselves seeking 10 or more new investors at one time.

As common as these challenges are, I firmly believe ASCs can prosper for far longer than 12 years. While it's true that even successful ASCs face natural fluctuations in case volumes at some point during their

existence, it's certainly not inevitable that they will become unprofitable or be forced to shut down. In fact, there are a number of specific and proactive steps surgeon-owners can take to extend the life and long-term profitability of outpatient surgery centers. The four rules of thumb I share below are emerging best practices that I have seen in action at leading centers around the country.

1. Plan ahead and don't delay taking action.

Just as investment counselors advise clients to start thinking about retirement early in their careers, ASC businesses should be formed with an eye on long-term transition plans. Surgeon-owners must understand the general timelines and career plans of all partners.

In fact, such questions should be part of the process of forming the original partnership group. This can make it slightly more difficult and time-consuming to find the right partners, but, in my experience, the most profitable ASCs are notable for their strong, cohesive ownership groups; the partners generally like and respect each other, enjoy practicing together and understand their responsibilities to the business.

Mature ASCs which did not form such plans at inception should move quickly to shape them, especially if retirement dates of key physicians are creeping up. If you wait too long before seeking to replace lost case volume, you may be forced to take on surgeons who are less than ideal for the business or make a bad deal with a new partner. The loss of trust among partners can be as potentially damaging as loss of revenue. Again, the time to start worrying about cases lost to owner retirements is – at a minimum – several years before those retirements take place.

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2. Always be recruiting.

Many outpatient facilities run into trouble because recruitment is not a priority or is conducted only sporadically. Dr. X's retirement is viewed as something to worry about in 2010. Unfortunately, the most attractive ownership prospects may come along in 2008, and will have their own timeframes for decision making. This is why I recommend to my ASC clients that the right prospects be invited to join the partnerships whenever they – and not necessarily the centers – are ready. In other words, you should always be recruiting.

Further, every surgeon-owner should accept responsibility for recruitment as a continuous activity. In practice, this means all partners should be on the lookout at all times. They should bring likely candidates and their medical staff to the center, and cultivate relationships with them. When there is time for all parties to get to know one another, it's more likely that you'll find the right new partners, ones you trust and feel comfortable practicing with. And negotiations will be smoother.

If the entire ownership team is always in recruitment mode, you are less likely to find yourself in the dire straits where you're desperately seeking several new partners simultaneously or forced to make hasty decisions. A caveat: if everybody participates in recruiting, everybody must be aware of the regulatory prohibitions, like those that forbid offering inducements to surgeons to bring cases to the center.

If constant recruiting sounds like a lot of work, just consider that the need for case volume never goes away. Steady, consistent effort by several owners actually makes it easier to identify and attract clinically outstanding and appropriate surgeons. Yes, it takes work, but the payoff is a business structured for sustainable profitability.

3. Don't worry about matching buyers and sellers.

A common misconception in our industry is that every surgeon who wants to join the partnership must be matched to or balanced with a surgeon exiting the group. While such good timing is very nice to have, you shouldn't wait on it because you may lose out on good candidates. Again, the new surgeon-owner's timeline should be the priority.

Some partners will be reluctant to dilute the stakes of existing owners by taking on new partners. It's a legitimate concern, but certainly a manageable one. For instance, if all owners agree to slightly reduce their stake, the overall dilution effect is minimal. Moving from 100 shares outstanding to, say, 104 is a small price to pay for greater long-term stability for the business.

Plus, such a forward-looking strategy helps ensure that you remain selective in choosing the best surgeons to participate in the business. Again, ASCs should take on the right new partners whenever they find them, even if it means some dilution in the near term.

Reasonable, near-term dilution is a small price to pay for long-term profitability.

4. Target 10% annually.

Long-term planning and continuous recruitment are two ways to help ensure your ASC ages gracefully. But let's talk about specifics. The goal should be to increase the base by 10% every year. A group with 10 surgeons averaging 150-200 cases per year will want to add at least one new surgeon to practice at the center every year. That way, if Dr. X decides to retire a year early, there's no last-minute scramble to replace his cases.

The 10% target may seem high to surgeons who hate the idea of diluting shares, but, here again, there are proven steps to take. For instance, new partners may receive a smaller number of shares up front – say, five,

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as opposed to the 10 each original owner purchased at inception. Owners may also want to explore tempering the valuation of the center by paying a one-time dividend to owners, recapitalizing and/or ensuring all debt is reflected in the center's valuation.

Other Considerations

These seemingly small steps are proven and powerful ways that ASCs can extend their lifespan. They are not, however, the only options. To bolster sagging case volumes, management of mature ASCs can bring in a hospital as an ownership partner or adjust contracts to allow for more managed care procedures to be handled on an outpatient basis. Re-structuring ASCs as hospitals may make sense for some outpatient facilities. Suffice it to say that each of these approaches has its own risks.

Another effective option – and one that has helped many underperforming businesses turn around their operations – is to work directly with an outside management company. These relationships are most effective when there is a high degree of trust between partners and incentives are properly aligned around win-win objectives. Experienced partners with the right mix of skills and knowledge – in contracting, claims management and billing, to name just a few critical areas – can really make a difference when margins get tight at a mature ASC.

The Bottom Line: A Long, Happy Life

There can be no doubt that ASCs have become staples of the healthcare industry and are likely to remain so for a very long time. In other words, our industry is maturing. The critical question for stakeholders is no longer whether to invest in ASCs, but rather how to make the most of those investments over the long term. Typically, that means extending the lifespan of centers even as partnership groups evolve and case volumes fluctuate over time. The proactive management steps outlined above are the emerging best practices that will help ensure long-term profitability as our industry – and your ASC – moves into middle age.

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