

# Impact of Physician-owned Limited-service Hospitals: Wichita, KS Case Study

**February 16, 2005** 

Based on a case study of market dynamics and community impacts completed by McManis Consulting between July and December 2004.



### **Executive Summary**

- Five physician-owned limited-service hospitals opened in Wichita between 1999 and 2003 – two heart hospitals, one spine hospital and two surgical hospitals. \*
- Physician-owners referred to their own limited-service hospitals patients who:
  - Needed procedures that were well-paid
  - Had insurance that offered good reimbursement
  - Required procedures that could be scheduled in advance (elective, not emergency)
  - Tended to be in good overall health \*\*
- Most patients not meeting these criteria continued to be treated at the full-service hospitals.

<sup>\*</sup> Four of the limited-service hospitals were established and owned by physicians and local investors. The fifth was a 60/40 joint venture between Via Christi, a full-service healthcare system, and physicians.

<sup>\*\*</sup> Sicker patients admitted to the limited-service hospitals were frequently transferred to the full- service hospitals.

### **Executive Summary**

### Impacts included:

- A reduction in the financial performance of the area's fullservice hospitals
- Cutbacks in services offered by the full- service hospitals
- Increased community-wide service capacity for wellreimbursed services but decreased capacity for poorlyreimbursed services
- High profits at the limited-service hospitals
- A 15% increase over a 5-year period in the number of cardiac procedures performed in Wichita

## Reductions in Services at Wesley Medical Center \*

- Laid off 120 full-time equivalent (FTE) employees in 2001 and another 54 FTEs in 2003
- Sold Occupational Medicine Clinic
- Closed Electron Microscopy Research Center
- Closed pharmacy research program

## Profitability at Kansas Heart Hospital, 2002 \*\*

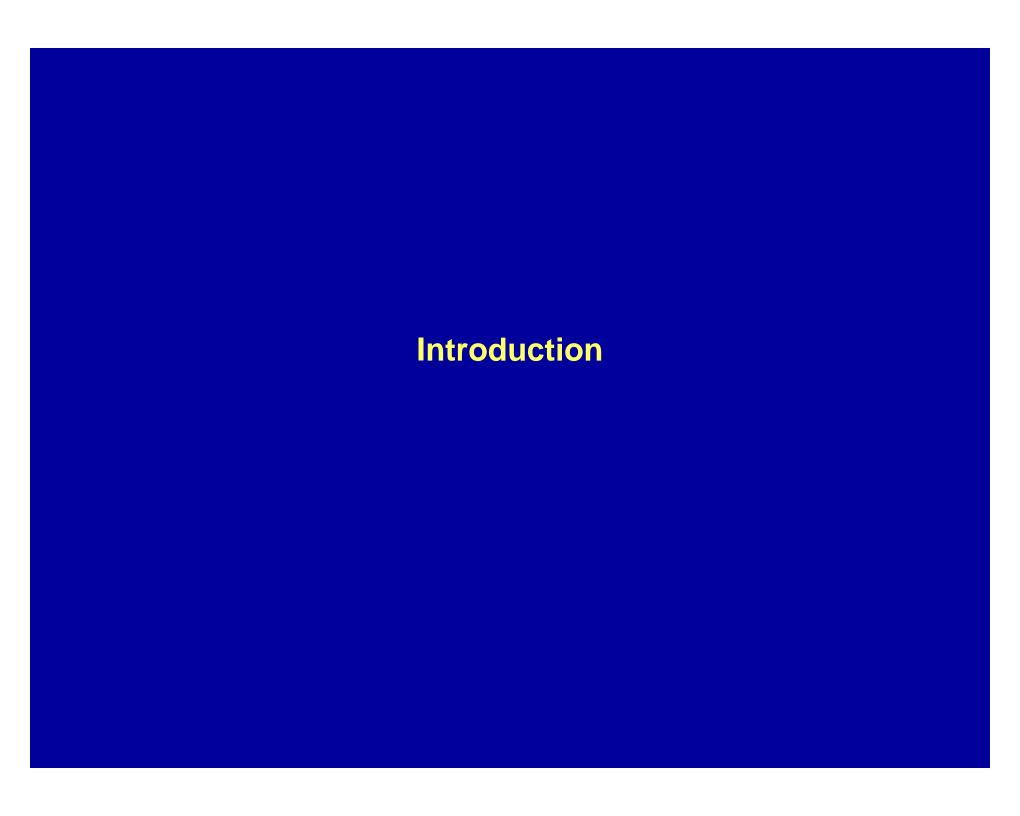
Net revenue \$43 million

Net income \$14 million

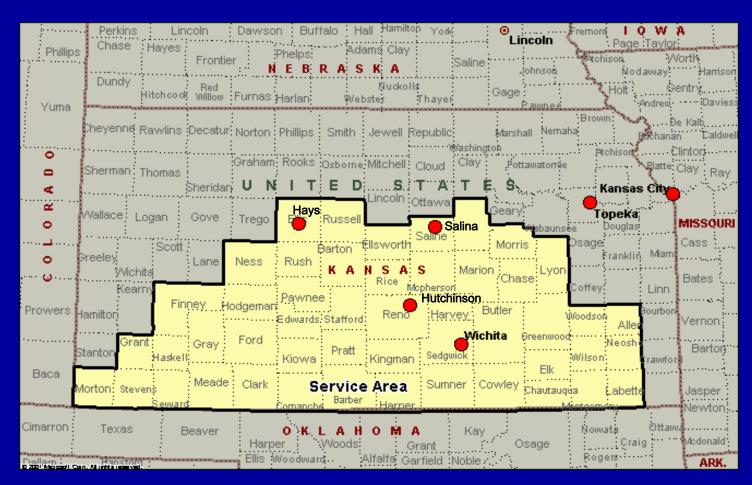
Profit margin 32%

Net income per admission \$5,261

- Source: Wesley Medical Center administration.
- \*\* Source: Medicare cost reports.



# Wichita's regional hospitals and physicians serve a population of 1.2 million spread throughout 49 counties in southern Kansas.



The service area as a whole has an aging, slowly declining population; however, the Wichita Metropolitan Statistical Area (pop. 532,000 in 2004) has a younger than average population that continues to grow.

## A broad complement of health care facilities serve the region.

### Regional hospitals in Wichita:

Via Christi–St. Francis and Via Christi–St. Joseph (total of 965 beds, operated as one system, product of a 1995 merger of two Catholic systems, full range of services, 95,000 emergency visits per year)

**Wesley Medical Center** (469 beds, owned by HCA, full range of services, 58,000 emergency visits per year)

### Other regional referral hospitals in the service area:

Community hospitals in Hutchinson, Hays and Salina

### Physician-owned surgical and diagnostic facilities in Wichita:

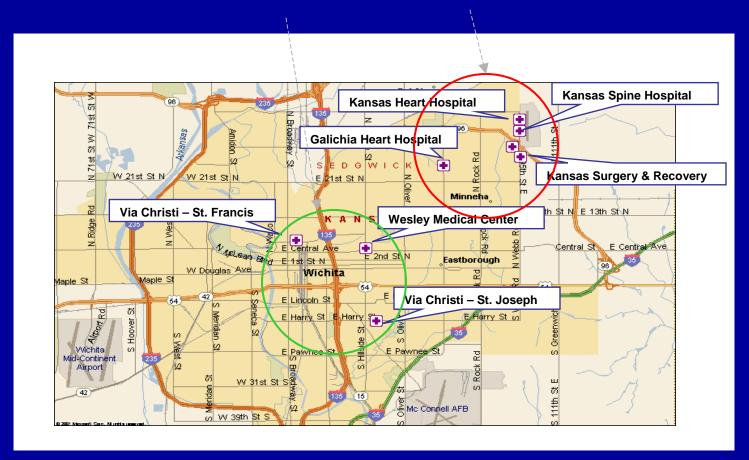
Seven physician-owned surgery centers, one plastic surgery center, two endoscopy centers

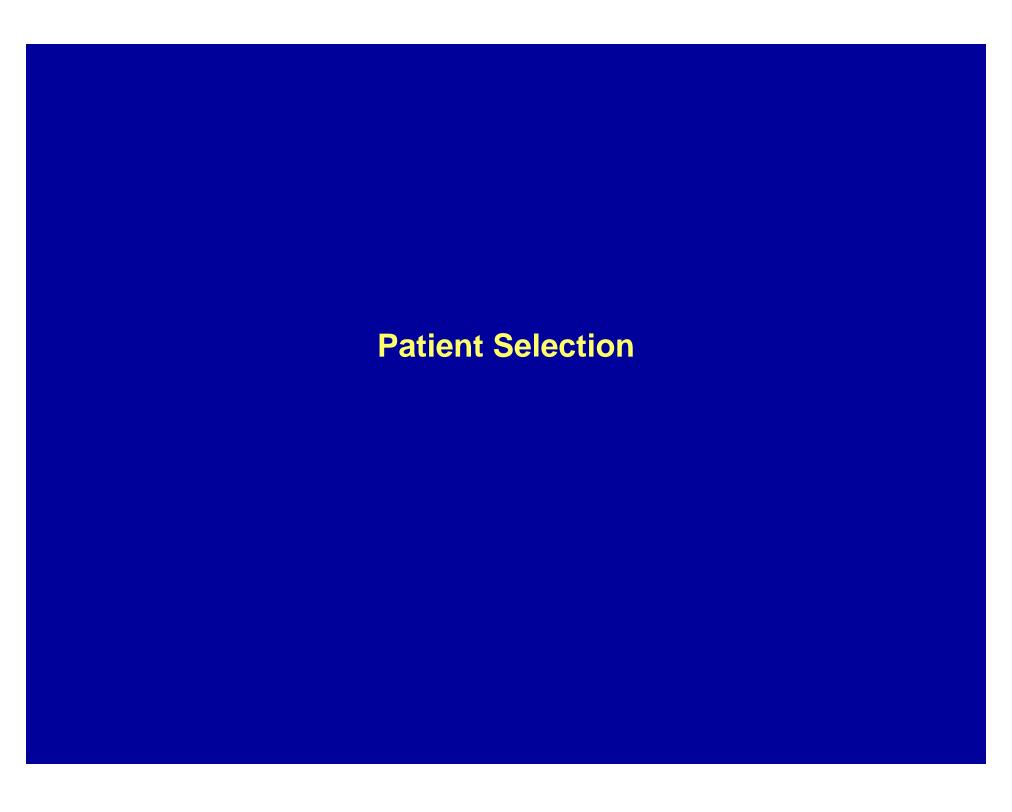
## Four limited-service hospitals opened in Wichita between 1995 and 2005.

| Limited-<br>service<br>Hospital                | Emphasized<br>Services                 | Ownership / Physician<br>Linkages  | Capacity   | Opening<br>Date |
|--|--|--|--|-----------------|
| Kansas<br>Heart<br>Hospital                    | Heart Surgery,<br>Cardiology           | Established and owned by 26 cardiac surgeons and cardiologists (who mostly practiced at Via Christi's hospitals) and local investors   | 54 inpatient beds,<br>3 operating rooms                          | 1999            |
| Galichia<br>Heart<br>Hospital                  | Heart Surgery,<br>Cardiology,<br>Other | Established and owned by two physicians and local investors (linked to and supported by the Galichia Medical Group, a 27-physician multi-specialty, "cardiology-based" practice) | 55 beds (adding another 27 beds), 2 operating rooms              | 2001            |
| Kansas<br>Spine<br>Hospital                    | Spine Surgery                          | Established and owned by 9 surgeons and local investors  | 22 inpatient beds,<br>4 operating<br>rooms, 2<br>procedure rooms | 2003            |
| Kansas<br>Surgery<br>and<br>Recovery<br>Center | Surgery<br>(focus on<br>orthopedics)   | 60/40 joint venture between Via Christi and orthopedists   | 24 inpatient beds,<br>6 operating<br>rooms, 2<br>procedure rooms | 1995            |

# While the community hospitals are located around downtown Wichita, the limited-service hospitals are clustered in Wichita's more affluent northeast quadrant.

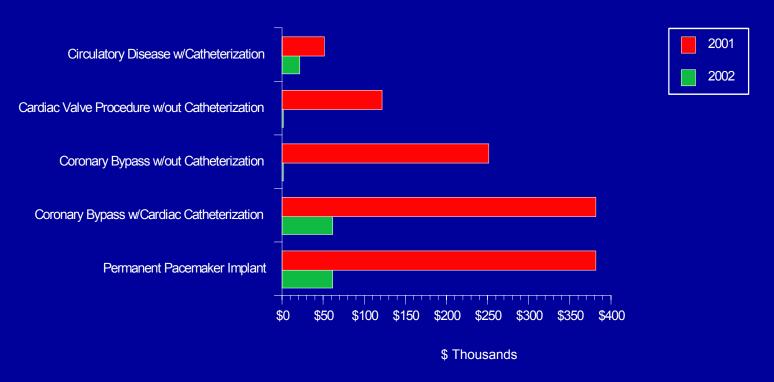
Full-service Limited-service Hospitals Hospitals





## Physician-owners were immediately successful in steering selected patients to the new heart hospitals.

Reductions in Net Revenues from Blue Cross Blue Shield Cardiac Cases at Wesley Medical Center the Year Galichia Heart Hospital Opened



Source: Wesley Medical Center administration. Wesley had a preferred provider relationship with Blue Cross Blue Shield, which meant that patients would normally have to pay more to go to another hospital. However, the heart hospital waived the added fees. This is legal in Kansas but is illegal in some other states.

# Patient selection was key to creating high profits in limited-service hospitals ... but adversely impacted the local health care system.

Patient selection tactics by the limited-service hospitals

 Focus on Well-reimbursed Procedures

 Avoid Emergency Cases

 Focus on Patients with Good Reimbursement  Focus on Patients in Good Overall Health

- resulted in -

High profits for limited-service hospitals and their investors

- but also -

Reduced resources available to meet the community's broader health care needs

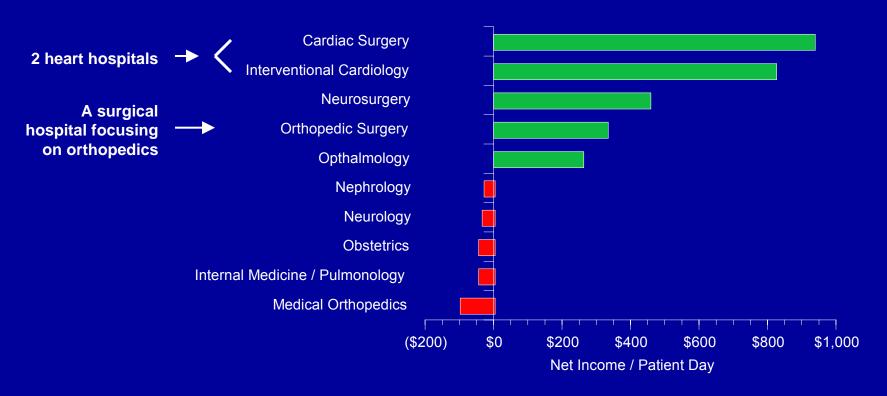
## Why do these patient selection tactics yield high profits?

### **Certain services and patients are more profitable than others:**

- Procedure-based services -- cardiovascular care, spine surgery, orthopedics, general surgery -- tend to pay more relative to costs than medicine, obstetrics, and behavioral health
- Private payers pay more relative to costs than Medicare and Medicaid
- Fixed payment systems don't reimburse more for sicker patients, except for "outliers"
- The standby capacity for emergency services is costly to maintain and is under-reimbursed
- Not having an emergency department allows a facility to be selective in which patients it serves (in terms of payers, services and acuity level)

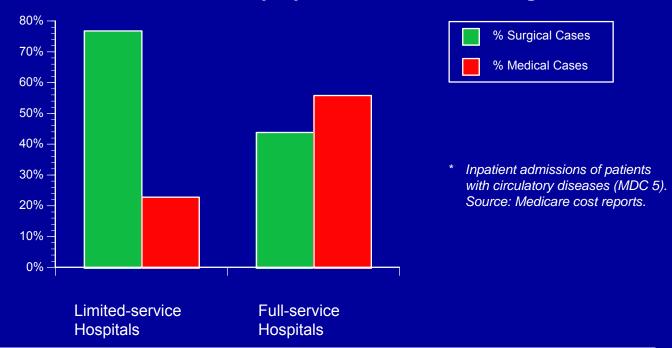
## The limited-service hospitals focused on well-paid services provided by community hospitals ...

## Net Income per Patient Day, Selected Cases, for a Typical Hospital



# The heart hospitals focused on the more well-paid surgical (as opposed to less well-paid medical) procedures.

#### Distribution of Circulatory System Medical and Surgical Cases \*



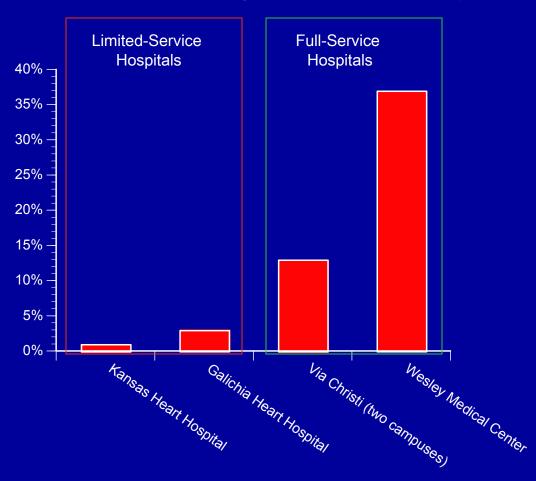
#### **MEDPAC's Findings on Profitability of Heart Cases**

"Except for DRG 116, pacemaker implant, all of the surgical DRGs are relatively more profitable than the national average. Medical DRGs are relatively less profitable."

Source: Julian Pettengill, Medicare Payment Advisory Commission, Public Meeting, October 28, 2004.

## The limited-service hospitals avoided patients with poor reimbursement.

### Medicaid as a Percentage of Total Patient Days, 2002



<sup>\*</sup> Source: Medicare cost reports., Data Advantage Corporation. Wesley Medical Center's percentage is unusually high for a full-service hospital because of the center's role in neonatal care.

# The limited-service hospitals did not offer emergency services.



## Avoiding emergency services allowed the limitedservice hospitals to avoid certain costs and scheduling inefficiencies ...

#### Managers were able to:

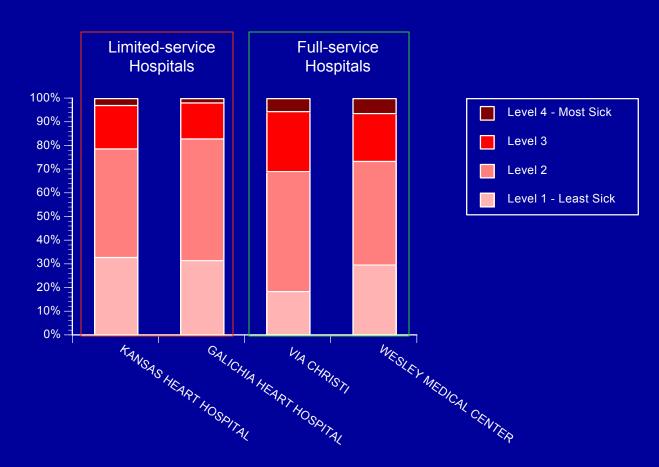
- Avoid purchases of seldom-used equipment
- Plan in advance without the potential for emergency cases to disrupt the schedule
  - → Match staffing to cases, avoiding the costs of standby capacity
  - → Offer an attractive schedule for physicians (free of interruptions)
  - → Provide physicians with a practice environment without the responsibilities of night and weekend call
- Exert control over acuity and payer mix (avoiding EMTALA\* mandate)

## By contrast, community hospitals must be prepared to handle all emergencies.

<sup>\*</sup> The Emergency Medical Treatment and Labor Act (EMTALA) requires hospitals with emergency departments to screen and stabilize all patients, regardless of ability to pay.

## Patient selection by physician-owners led to the sickest patients being admitted to the full-service Via Christi.

#### **APR-DRG Mix in Wichita Hospitals (Cardiac Cases)**



# Physicians transferred patients to full-service hospitals when their needs exceeded the capabilities of limited-service hospitals.

## Via Christi's Experience with Patient Transfers from Limited-service Hospitals

| Limited-service<br>Hospitals       | Patients<br>Transferred<br>to<br>Via Christi | Deaths of<br>Transferred<br>Patients at Via<br>Christi |               |
|------------------------------------|--|--|---------------|
| Kansas Heart Hospital              | 21   | 8  | 38% mortality |
| Galichia Heart Hospital            | 18   | 6  | 33% mortality |
| Kansas Surgery and Recovery Center | 12   | 0  |               |

Source: Via Christi administration. Comparable data were not available for the Kansas Spine Hospital.

# Impacts on the Health Care Delivery System

## The limited-service hospitals were quickly profitable.

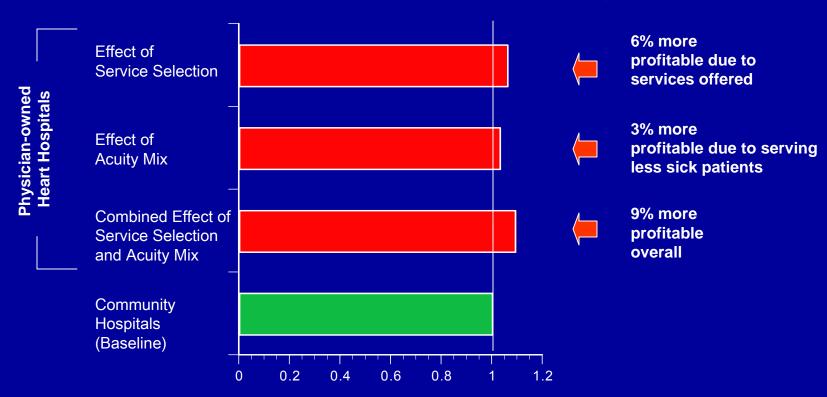
### **Kansas Heart Hospital Financial Performance, 2000-2002**

|  | 2000         | 2001          | 2002         |
|--|--------------|---------------|--------------|
| Net Revenue                              | \$34 million | \$ 40 million | \$43 million |
| Net Income                               | \$12 million | \$14 million  | \$14 million |
| Profit Margin (Net income / Net Revenue) | 36%          | 34%           | 32%          |
| Total Discharges                         | 1,980        | 2,402         | 2,642        |
| Net Income/Discharge                     | \$6,184      | \$5,751       | \$5,255      |

Source: Medicare Cost Reports, Data Advantage Corporation. The Galichia Heart Hospital and the Kansas Surgery and Recovery Hospital both generated 13% margins in 2002 (the most recent year for which data were available).

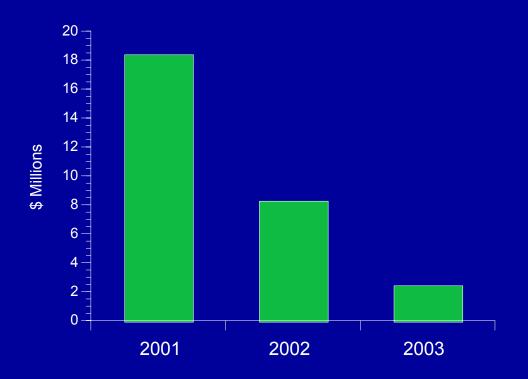
# Wichita findings are consistent with a recent MedPAC study which found that choosing profitable services and serving less sick patients contribute to higher profits for physician-owned heart hospitals.

**Expected Relative Profitability of Physician-owned Heart Hospitals Given Service Selection and Lower Acuity Mix (Within DRG)** 



# Meanwhile, the full-service hospitals saw corresponding reductions in revenues and net income.

#### **Net Revenues from Wesley Medical Center's Heart Program**

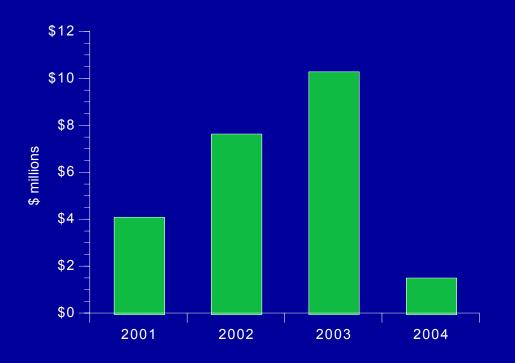


Net revenues in Wesley Medical Center's heart program decreased by \$16 million after the opening of Galichia Heart Hospital in 2001.

Source: Wesley administration.

## Full-service hospitals' financial position suffered with the introduction of each new limited-service hospital.

## Net Revenues from Wesley Medical Center's Neurosurgery Program

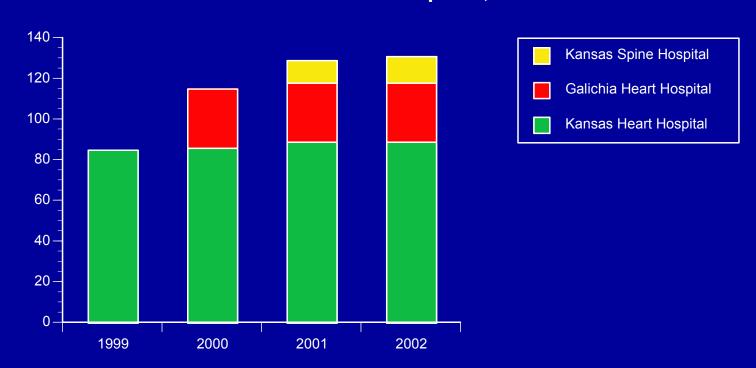


Wesley Medical Center's net revenues in neurosurgery dropped \$8.8 million after the opening of Kansas Spine Hospital in 2003.

Source: Wesley administration.

# Key staff left the full-service hospitals to join the limited-service hospitals.

## **Cumulative Staff Losses by Via Christi to Three Limited-Service Hospitals, 1999-2002**



Source: Via Christi administration.

# Full-service hospitals had to reallocate resources – investing more to rebuild affected services, while cutting back elsewhere.

Wesley Medical Center's Actions Following the Opening of Galichia Heart Hospital and the Kansas Spine Hospital

# Competing with Limited-service Hospitals to Maintain Critical Programs

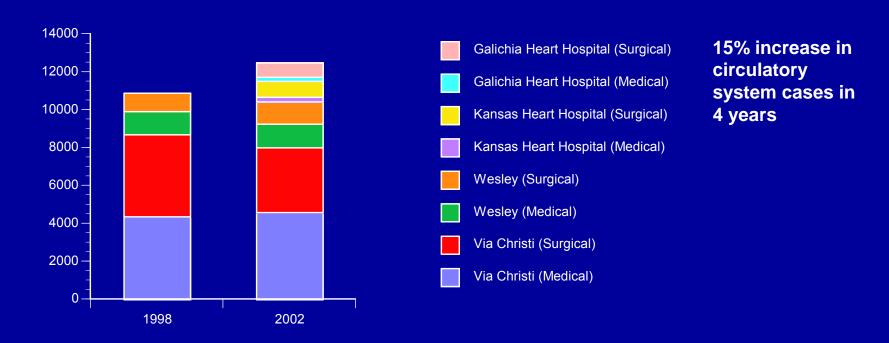
 Increased cath lab staff salaries an average of \$2 per hour (cost \$2.5 million a year) and paid retention bonuses of \$7,500 each

## **Cutting Back on Other Subisdized Services**

- Laid off 120 full-time equivalent (FTE) employees in 2001 and another 54 FTEs in 2003
- Sold Occupational Medicine Clinic
- Closed Electron Microscopy Research Center
- Closed pharmacy research program

## Total resources increased for services targeted by the limited-service hospitals, and so did the number of cases.

#### **Circulatory Cases in Wichita Hospitals, 1998-2002\***



<sup>\*</sup> Inpatient admissions of patients with circulatory diseases (MDC 5). Sources: Medicare Cost Reports, Data Advantage Corporation, Via Christi and Wesley administrations.

### **Summary**

- Wichita was a highly competitive health care market when five new limited-service hospitals were introduced.
- Physician-owners quickly directed selected cases (involving well-paid procedures, good payers, elective procedures, healthier patients) to the limited-service facilities, while the remainder continued to be treated at the full-service hospitals.
- Competition became more intense for the cases that were targeted by the limited-services hospitals...
  - Duplicative investments in facilities
  - Intense competition for skilled staff
  - Forgiveness of out-of-network co-pays by the limited-service hospitals
- Total utilization for these targeted cases increased.
- Meanwhile, other services were reduced as health care dollars that had previously been available to subsidize poorly reimbursed services became profits for physician-investors.



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