



# 2006 HSR Impact Awardee

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## Specialty Hospitals

### SNAPSHOT OF SUCCESS

#### Competition for Profitable Services Drives Specialty Hospital Boom

**The AcademyHealth Health Services Research Impact Award (HSR Impact Award) recognizes outstanding examples of the positive impact of health services research on health policy or practice. HSR Impact Awards are evaluated based on the quality of research presented, success of the translation to policy or practice, and benefit to the target population. The award is presented annually.**

#### THE ISSUE

*In recent years, hospitals specializing in cardiovascular, orthopedic or general surgery procedures have grown rapidly in certain parts of the country. Proponents suggest that these “specialty hospitals” can increase competition, improve quality, and reduce costs. Skeptics counter that specialty hospitals will reduce quality, increase costs system-wide, and decrease access to basic services by undermining general hospitals’ ability to cross-subsidize unprofitable care. A central factor in the debate about specialty hospitals is the role that physician ownership plays in the volume of services used, as well as the differing health status of patients who are referred to specialty hospitals versus general hospitals.*



Since 1996, the Center for Studying Health System Change (HSC), a nonpartisan policy research organization funded principally by The Robert Wood Johnson Foundation, has tracked 12 nationally representative metropolitan health care

markets through periodic site visits to identify emerging trends. During HSC’s fourth round of site visits in 2002-03, researchers found that hospitals specializing in cardiac and orthopedic care were developing rapidly in several of the sites and throughout the country, raising challenging questions for policymakers.

Health services researchers from HSC investigated the upswing in specialty hospitals to identify what factors were driving the trend, assess the potential cost and quality of care implications, and provide information for policymakers.

Researchers identified two major schools of thought on specialty hospitals. Advocates suggest that specialty hospitals can improve quality and reduce costs by increasing productivity through a “focused-factory” approach where physicians perform a high volume of a narrow range of procedures. But skeptics worry specialty hospitals and their physician investors will “cream skim” the most profitable patients away from general hospitals, cutting into bottom lines and threatening the cross-subsidization of unprofitable services, such as care for the uninsured. Another concern is that physician ownership will lead to higher overall volume of service use.

In theory, using a focused-factory approach in health care can potentially improve quality, increase productivity, and lower costs, but if the payment system is distorted, specialty hospitals can prosper financially without achieving the goals of higher quality and increased productivity. From a regulatory perspective, federal laws limit physicians’ ability to refer Medicare and Medicaid patients to health care facilities, such as clinical laboratories, in which they have a financial interest, but the law exempts physician investment in whole hospitals.

HSC researchers identified three main drivers of the specialty hospital boom: relatively high facility payment rates for certain surgical procedures, especially for cardiovascular care; physicians’ desire for greater control over management decisions affecting productivity and quality; and specialists’ efforts to increase their income in the face of static or declining reimbursements for professional services.

General hospitals responded to the competitive threat posed by specialty hospitals in a variety of ways, including:

- ◆ Building their own specialty facilities to maintain revenue from profitable services and retain physicians who otherwise might leave to develop a competing specialty hospital. By offering physicians some of the advantages of a freestanding facility, such as improved scheduling and staffing, these hospitals hoped to deter physicians from creating competing facilities.
- ◆ Forming joint ventures with local physicians to build a specialty hospital, which lets the general hospital retain a portion of the facility revenue that otherwise might be lost, while allowing the physicians to invest in the venture.
- ◆ Denying admitting privileges to physicians who have a financial interest in a competing facility. Called “economic credentialing,” this practice has sparked lawsuits, with some courts upholding hospital actions to restrict physician privileges.

Along with examining the market dynamics driving the growth in specialty hospitals, HSC research showed that underlying distortions — i.e., certain services are relatively more profitable than others — in the Medicare inpatient prospective payment system were likely contributing to the proliferation of specialty hospitals. As a result, the Medicare Payment Advisory Commission (MedPAC) studied the relative profitability of various services commonly provided in specialty hospitals and recommended that the Centers for Medicare and Medicaid Services (CMS) adjust the payment system to account for overpayment of certain services.

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*Specialty Hospitals (continued)*

"The specialty hospital building boom and intense competition for profitable cardiac and orthopedic services were clear signs that inadvertent payment distortions were influencing providers' decisions about what service lines to invest in," said HSC President Paul B. Ginsburg, Ph.D., who coauthored the April 2003 study on specialty hospitals along with former HSC Health Researcher Kelly J. Devers, Ph.D., now an associate professor at Virginia Commonwealth University, and former HSC consulting researcher Linda Brewster.

HSC's research facilitated congressional consideration of the issues related to specialty hospitals and in December 2003, Congress placed an 18-month moratorium on new specialty hospitals taking part in Medicare. Congress also directed MedPAC and CMS to conduct additional research on the issues. MedPAC found that physician-owned specialty hospitals treat patients who are less severely ill than average and concentrate on relatively profitable conditions. MedPAC also found that specialty hospital costs for inpatients were not lower than general hospitals, although specialty hospital patients had shorter average lengths of stay. The CMS study

concluded that specialty hospitals generally provide quality care, with somewhat lower complications and mortality rates in cardiac specialty hospitals than in general hospitals, but with a higher rate of readmissions.

When the moratorium expired on June 8, 2005, CMS announced it would delay approval of any new, physician-owned specialty hospitals for at least six months while the agency reviewed its enrollment procedures for specialty hospitals. Legislation expected to be enacted in early 2006 would further prohibit specialty hospital enrollment in Medicare for up to another eight months.

During HSC's 2005 site visits, researchers found that while the moratorium had stalled development of new specialty hospitals, the proliferation of physician investment in freestanding outpatient facilities and increased provision of ancillary services in physician offices continues unabated, raising worrisome implications for costs. Indeed, the proliferation of physician ownership of outpatient facilities is likely to have a larger impact on the health care system, for better or for worse, than the development of specialty hospitals.

## FACTS

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- ◆ More than two-thirds of the 100 specialty hospitals operating as of June 2003 had opened since 1990, according to the Government Accountability Office.
- ◆ Physicians owned approximately 70 percent of these specialty hospitals, in part or in whole.

## RESOURCES

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Center for Studying Health System Change, Conference transcript, "Specialty Hospitals: Focused Factories or Cream Skimmers?" (April 15, 2003). Accessed at [http://hschange.org/CONTENT/555/?id\\_conf=13](http://hschange.org/CONTENT/555/?id_conf=13)

Centers for Medicare and Medicaid Services, "Specialty Hospital Evaluation, Final Report," (September 2005). Accessed at <http://new.cms.hhs.gov/reports/downloads/cromwell3.pdf>

Medicare Payment Advisory Committee, "Physician-Owned Specialty Hospitals, March 2005 Report to Congress." Accessed at [http://www.medpac.gov/publications/congressional\\_reports/Mar05\\_SpecHospitals.pdf](http://www.medpac.gov/publications/congressional_reports/Mar05_SpecHospitals.pdf)

Government Accountability Office, "Specialty Hospitals: Geographic Location, Services Provided, and Final Performance" (Oct. 22, 2003). Accessed at <http://www.gao.gov/new.items/d04167.pdf>

## What is health services research?

Health services research examines how people get access to health care, how much care costs, and what happens to patients as a result of this care. The main goals of health services research are to identify the most effective ways to organize, manage, finance, and deliver high-quality care; reduce medical errors; and improve patient safety.

— Agency for Healthcare Research and Quality

## FURTHER READING

Devers, Kelly J., Linda R. Brewster and Paul B. Ginsburg, *Specialty Hospitals: Focused Factories or Cream Skimmers?* Issue Brief No. 62, Center for Studying Health System Change (April 2003).

Berenson, Robert A., Gloria J. Bazzoli and Melanie Au, *Do Specialty Hospitals Promote Price Competition?* Issue Brief No.103, Center for Studying Health System Change (January 2006).

Ginsburg, Paul B., and Joy M. Grossman, "When The Price Isn't Right: How Inadvertent Payment Incentives Drive Medical Care," *Health Affairs* Web Exclusive (Aug. 9, 2005).

Iglehart, John K., "The Uncertain Future of Specialty Hospitals," *New England Journal of Medicine*, Vol. 352, No.14, (April 7, 2005)

Casalino, Lawrence P., Kelly Devers and Linda R. Brewster, "Focused Factories? Physician-Owned Specialty Facilities," *Health Affairs*, No. 22, Vol. 6, (November/December 2003).

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