

Published by

Bader & Associates

Governance Consultants,

Potomac, MD



Joint Venture Governance: an Often Overlooked Success Factor

By Barry S. Bader,
Elaine Zablocki and
Carlin Locke

Hospitals and health systems are using joint ventures as a significant vehicle to pursue business opportunities with physicians, health companies. Effective governance is a key element in their success.

Joint ventures account for an important and increasing share of hospital revenues. Physician-hospital joint ventures are the most common. For hospitals, they're fueled by a desire to retain a share of revenues from lucrative services, such as imaging and outpatient surgery, that they'd otherwise lose to physician-owned enterprises. For physicians, the joint venture is a way to increase revenues and gain increased control over their working environment, while retaining the hospital's goodwill towards them and taking advantage of its management expertise, access to capital and other resources.

"We need to be proactive in this area," says Richard Afable, MD, MPH, President and CEO of 511-bed Hoag Memorial Hospital Presbyterian, Newport Beach, CA. "Our physicians want to set up businesses in medical areas that are now conducted within hospital walls, and they will do it with us or without us."

Rulon Stacey, President and CEO of Poudre Valley Health System, Fort Collins, CO, stresses that joint ventures are a means to an end—ultimately the hospital wants to strengthen hospital/physician relationships. PVHS makes money on many of its 18 hospital/physician ventures, but that's not a primary or even secondary motivation for the hospital, he says.

While the legal and financial aspects of setting up joint ventures receive substantial attention, governance turns out to be an unsung determinant of eventual success, say leaders we interviewed. Hospitals and their partners who are forming joint ventures are well advised to give careful forethought to the nature of the venture itself, the governance structure, board composition, and the strategic linkage between the parent board and its various joint ventures.

continued on page 2 →

→ continued from page 1

Questions at the Outset

Richard R. Sheridan, senior vice president and general counsel of Scripps Health, San Diego, CA, says that joint ventures generally follow one of two patterns: a venture that acts by negotiation and consensus, or a venture that pursues its own articulated business purpose. Each calls for a different approach to governance.

In the first case, the joint venture is essentially a format for negotiating and reaching consensus on operating an enterprise that benefits both parties. For example, a hospital and some gastroenterologists might form a joint venture to operate an outpatient endoscopy center. In seeking consensus, hospital-elected board members are charged with representing hospital interests, and physician directors represent theirs.

The second model is more oriented to governing a business designed to grow and largely determine its own destiny. Examples might include medical research companies or health plans formed as joint ventures.

Joint ventures generally follow one of two patterns: a venture that acts by negotiation and consensus, or a venture that pursues its own articulated business purpose.

— Richard R. Sheridan, senior vice president and general counsel of Scripps Health, San Diego, CA

“There is a watershed moment when you first set up the venture, and you decide which of these models you are following,” Sheridan says. “Pay attention at the start to the way you structure governance. Think about the roles you are asking joint venture directors to play. In particular, clarify whether they are going to carry out the hospital/health system’s position, or act on their own to further the joint venture. These are two very different models, and joint ventures fall apart when the parties fail to decide at the outset what sort of organization they are creating.”

Scripps generally follows the “joint venture as negotiating tool” model, and forms joint ventures in which the health system-appointed members of the joint venture board represent the system’s interests.

In contrast, the Sisters of Providence Health System, in Holyoke, MA, formed a for-profit joint venture with a 65-member physician group about eight years ago, says President and CEO Vincent McCorkle. “As members of the joint venture board, we take off our hats as ‘health system’ or ‘physician’ and make decisions that benefit the joint venture. At one point we realized the venture should own its own lab instead of contracting out [with the hospital] for lab services. That was difficult, but I cast my vote for the best choice from the joint venture’s perspective.”

OhioHealth, a system of 15 hospitals, has also devoted careful attention to defining its expectations for joint ventures. The Columbus-based system has adopted written “guiding principles” for potential joint ventures. For example, all arrangements must meet these criteria:

- support the mission, vision and values
- add community value
- strengthen OhioHealth’s business portfolio
- support the system’s strategic plan.

Further, OhioHealth’s joint ventures with physicians must:

- enable the system to sustain/grow market share in a clinical service line
- enhance accessibility of OhioHealth services to physicians and patients
- offer physician partners an opportunity to improve the clinical efficiencies of their practices.

continued on page 3 →

→ continued from page 2

According to President and CEO David Blom, each joint venture has a governing board, with a negotiated structure based on each party's percentage of ownership. OhioHealth's representatives typically include the executive with responsibility for the business unit itself, a member of the system's senior finance team, and a physician executive. One of those joint venture directors takes on the role of "accountable executive" and is responsible for ensuring that the joint venture is operated in accordance with OhioHealth's joint venture philosophy and guidelines. The OhioHealth general counsel's office offers an annual educational session for its joint venture board members to assure they are able to fulfill their expected roles.

Choose an Appropriate Board Structure

Who's in charge?

Physicians typically want control of decisions affecting daily operations and their revenues, while the hospital wants to ensure that the venture supports the hospital's mission, is profitable and doesn't compete with other hospital services. The joint ventures we examined addressed each party's interest in control through a mixture of board seats and reserved powers.

The Sisters of Providence/physician group joint venture is structured as a limited liability corporation with 50-50 ownership. It has an eleven-member board of managers, five from the health system and six from the physician group.

"We set up this structure because giving the physician group an extra board seat helped them feel they did control the joint venture. That was particularly important because they had a previous negative experience with a national physician management company," says McCorkle.

Providence retains the control it needs by having "reserved powers" over a handful of critical board decisions, such as appointment and removal of officers; approval of the capital and operating budgets and the strategic plan; and approval of mergers and acquisitions.

Hoag Hospital addresses each party's control needs with a two-level approach to joint venture governance, explains CEO Afaible. A joint venture board on which the hospital has at least 51% of the board seats oversees major capital expenses, strategic expansions and acquisitions. An operating level board focuses on operational issues, and physicians have the majority or sometimes all the seats on this board.

OhioHealth's guidelines require joint ventures to have an external audit and corporate compliance plan.

"The greatest barrier to effective joint ventures is testosterone poisoning—it kills deals," says PVHS CEO Stacey. "Doctors want the control, so it's important for the hospital to find ways to help meet that need." Physicians might choose the board chair, for example. The main goal from the hospital's point of view is to have a partnership that drives clinical improvement. Poudre Valley's joint ventures with doctors are meeting that goal, he says.

Near PVHS is Regional West Medical Center, a rural referral center in Scottsbluff, NE, that's building an ambulatory surgery center with four of its physicians. The joint venture governing board is hardwired at 50% physicians, 50% hospital, regardless of how the percentage of ownership changes. Regional West accepts a 50-50 board because it is able to control important decisions, such as the surgi-center's location, in other ways. "We retained ownership of the land, and the surgery center cannot be sold to outside interests without our approval," says President and CEO Todd Sorensen, MD.

continued on page 4 →

→ continued from page 3

Regional West also has 12% ownership in a joint venture with Poudre Valley to build a new hospital, Medical Center of the Rockies (MCTR) in a fast-growing area located between them. Stacey calls it the “ultimate joint venture.”

The new facility will be governed by the PVHS board of directors, but Regional West has one seat on that board and retains important reserved powers pertaining to operation of the venture. “If either Poudre Valley or Regional West commits to a course of action that would compromise the venture, there is a provision allowing for dissolution of the venture at a premium or discount that would compensate the disadvantaged party,” Sorenson says.

In structuring joint ventures, tax-exempt hospitals also need to have control to ensure the joint venture does not jeopardize their charitable status. Some also want to avoid treating joint venture revenues as taxable, unrelated business income. Scripps’ Sheridan explains that although

recent court cases suggest less than 51% control may be acceptable, “we generally try to set it up as 51% control because then there is little doubt that we have enough control to have our income be tax-exempt. What you need is for the non-profit parent to have adequate control to ensure that the non-profit mission is imposed upon the joint venture. If you have the ability to impose the parent’s charitable mission, chances are your income from the joint venture will be tax-exempt, even if you have less than 51% ownership.”

community member from the parent board, but adding other “outside directors” for their expertise is less common and may meet resistance.

The Sisters of Providence joint venture was set up with no outside directors. “We were negotiating with a physician group that due to its previous experience was very wary of people who might approach them in a heavy-handed way, not respecting them as equals,” McCorkle says. “In theory, I think it would be better to have outside directors. In this joint venture, we are

When Hoag sets up a joint venture, most of the governing board members are from hospital management, but at least one is a non-management hospital board member. “If the joint venture’s business is profoundly different from the hospital’s line of business, then a true outside director with relevant business expertise can be particularly valuable,” Afable says.

When Mountain States Health Alliance of Johnson City, TN formed a joint venture for a surgery center in Kingsport, about 30 miles from its flagship hospital, it added an outside director to the otherwise 50-50 board. “It seemed like a good idea, just in case we were ever at loggerheads and couldn’t reach a joint decision between the system and the physicians,” says Dennis Vonderfecht, President and CEO of the 11-hospital system. “We felt a community person would be a potential tie breaker, because [he or she] would have an independent viewpoint.”

An outside director might bring a fresh viewpoint to the mix.

— Vincent McCorkle, president and CEO,
Sisters of Providence Health System, Holyoke, MA

Choosing and developing joint venture directors

Who should serve on the joint venture board? Do “outside directors” bring any added value? At the organizations we interviewed, the hospital or health system usually appoints members of its executive team to the joint venture board. Sometimes the hospital also names a

working with the same physicians who also serve on our medical staff committees, so the mutual influences and inter-relationships can be complex. An outside director might bring a fresh viewpoint to the mix.”

continued on page 5 →

→ continued from page 4

St. Vincent Health System, in Erie, PA, has had several joint ventures for many years with Hamot, the second leading hospital in the area, to operate a blood bank, an emergency ambulance service, and a regional cancer center. Members of the community already serve on the blood bank and ambulance boards. In addition, says President and CEO Angela Bontempo, they are considering additional outside directors at several not-for-profit joint ventures. “The regional cancer center might add someone with special expertise, such as an academic oncologist, and/or a community member who has personal experience with cancer. In general, we’re looking for ways to increase the community representation and diversity of our boards.”

Memorial Hermann Healthcare System (MHHS), in Houston, avoided joint ventures until 2001. Then the board decided it would be open to joint ventures in “non-core [not inpatient]” business lines such as outpatient services and professional buildings. MHHS decided to use an existing for-profit corporation, Memorial Health

Joint ventures
need the
same degree
of focus as
the hospital,
or any other
part of our
enterprise.

— Dennis Vonderfecht,
president and CEO of
Mountain States Health
Alliance, Johnson City, TN

Ventures, Inc., as the oversight governing body for all joint ventures. The system repopulated the MHV board with experienced business members from other industries who already served on various system boards or came from the community. “It’s the strongest board we have of seasoned business veterans,” says President and CEO Daniel J. Wolterman.

Alignment with
the hospital’s strategic
plan

How can a hospital ensure that the joint venture’s strategic decisions remain aligned with the system’s vision, and how should the system board oversee the performance of a growing roster of joint ventures?

At Memorial Hermann, the Health Ventures board approved a strategic plan and “provides direction on types of ventures to engage in and how they should be structured,” Wolterman says. To oversee each joint venture, the HMV board reviews a report card with measures aligned with four system-wide strategies for quality, customer satisfaction, operational (including financial) excellence, and growth. “It’s been clear what the board wants in terms of a report card, and the board gets reports at every meeting against the pro formas for the venture,” Wolterman says.

It’s self-evident that the bigger the venture, the more oversight it merits. For instance, McCorkle calls the Sisters of Providence joint venture a “bet-the-farm strategy for our health system.” In a situation like this, of course the governing board carefully tracks progress. The joint venture

makes quarterly reports to the system board finance committee, and there’s a “big picture” report on the joint venture at every board meeting. “This joint venture strategy proved to be successful, increasing our market share from the group from 8% to about 50%,” says McCorkle. “If it had not been successful, there would certainly have been even more board oversight.”

For more than 10 years, DeKalb Medical Center, a three-hospital system in Atlanta, GA, has had a 50-50 joint venture PHO with about 500 physicians. While it is a for-profit entity, it is not designed to retain any significant revenue from negotiating managed care rates for its member physicians and hospitals. However, the PHO is able to present itself to the market as a single entity and win leverage in negotiating managed-care contracts due to significant clinical integration. Recently, during a period of difficult negotiations with one company, the physicians gave the PHO exclusive power to terminate their pre-existing managed-care contracts with that company. This joint venture is at the heart of DeKalb’s business strategy, says CEO Eric

continued on page 6 →

→ continued from page 5

Norwood, and thus the board's finance committee routinely evaluates its performance whenever it evaluates the system's managed-care contracts.

Recently, DeKalb embarked on a second joint venture, to be known as DeKalb Surgical Alliance. This "co-management joint venture" will manage four existing operating rooms in the hospital. The hospital has a 30% interest, physicians have a 50% interest, and an independent management company has a 20% interest. The goal is to create the most efficient environment for surgery in town, says Norwood. "We report on the success of this venture to the full board every month. It is a strategic project they've been following very closely."

The board of Mountain States Health Alliance relies on its finance committee to oversee several joint venture ambulatory surgery centers, with varying percentages of ownership. The committee reviews financial results compared to budget from each joint venture monthly. "If we're off target, then we look in greater detail at

what's happening with that part of the organization," says Vonderfecht. "Joint ventures need the same degree of focus as the hospital, or any other part of our enterprise."

Some systems bring to the board an external audit of joint ventures to ensure their dealings with partners meet "fair market value" standards and otherwise follow sound financial reporting practices. Independent audits help each party have confidence in the joint venture's integrity. OhioHealth's guidelines require joint ventures to have an external audit and corporate compliance plan.

Poudre Valley appoints managers from the system to sit on joint venture boards, and the system board gets monthly updates on quality scores from the joint ventures (through the system board quality committee). It also gets a monthly financial update, plus an annual, more comprehensive, update.

Governance Counts

Attorneys may craft the legal agreement creating a joint venture, but the authority, composition and reporting relationships of joint venture governance heavily influence its success.

A recent study by McKinsey & Company of joint ventures in public companies found that joint ventures are growing, accounting for 10 for 20 percent of company revenues on average, but they aren't subject to the same oversight as owned enterprises. "That's a risk," the study concludes. The study recommends joint ventures have at least one outside director, a strong chair or "lead director," and an external audit. It also recommends that joint venture directors be evaluated and rewarded for their joint venture service.

Just how important is joint venture governance? "It's been critical to the success of our experience with joint ventures," Wolterman says. "We were late entering this market, and we lost outpatient business because of it. Creating clear guidelines and recruiting a solid, seasoned board to guide the strategic plan and monitor the ventures were important factors that paved our way to success."

Barry S. Bader, publisher of *Great Boards*, is the president of Bader & Associates, a Maryland-based governance consulting firm.

Elaine Zablocki, editor of *Great Boards*, is a freelance healthcare journalist whose work has appeared in *Physician Practice*, *Internal Medicine News*, *Medicine on the Net*, and numerous other publications.

Carlin Lockee is the managing editor of *The Governance Institute*, which assisted in the research for this article.