MARKETING OPPORTUNITIES IN THE RAPIDLY CHANGING PRACTICE OF MEDICINE

Providers of healthcare are finding newer, more cost-effective ways to market their services to the cost-conscious consumer.

by Lawrence P. Darrow, CRE and J. Robert Pellar

Medical practice is in a state of major transition as hospitals unbundle services and create a vast potential for new market ventures in health care. Services such as diagnostic testing, treatment, emergency care, and surgery, now are being offered in freestanding centers. Hospitals and physicians can either gain a foothold in this fast growing health care market or risk losing a major portion of business to new providers.

Modern Trends

The emergence of health care as a competitive industry is partially a reaction to the escalation of medical costs over the past 20 years. Government spending in this area has risen from 8.6-10.2% of the Gross National Product (GNP) between 1975-82; and real costs more than doubled. Projections by the Center of Health Policy Studies in Washington, D.C. indicate total care spending will reach 13% of the GNP by the year 2,000, and will rise substantially in real terms at 4.7% per year. Personal health care expense also is expected to increase to 10.3% per year; spending on hospital service will rise 11%; and costs for physician care will increase 9.9%.

The health care community, government, the insurance industry, employers, and consumers all have supported legislation to curb rising costs by greater regulation and

by providing incentives for consumers to shop for more competitive service. Consequently, legislative changes have caused a decline in hospital admissions which typically provides the highest-priced service. It is projected that hospital admissions will continue to decline 25% over the next five years, while outpatient services will increase proportionately. While hospitals formerly depended on inpatient services to provide 80-90% of their revenues, outpatient and ambulatory care now must capture those funds.

Several other factors also have contributed to the new emphasis upon ambulatory care: an increase in physicians providing specialized services which do not require a hospital setting; the technological advancements that allow diagnostic tests and therapeutic regimens to be performed on an outpatient basis. Since outpatient care is cost-effective to the consumer and provider, such services could present many market opportunities for

Lawrence P. Darrow, *CRE, is director of real estate consulting in the Management Consulting Services Group of Coopers & Lybrand, Chicago. He has been involved in real estate since 1961 and specializes in real estate appraisals, consultation, finance, equity syndication, development, and management. Darrow is an active member of several real estate associations including the American Society of Real Estate Counselors and the American Institute of Real Estate Appraisers.*

J. Robert Pellar *is a partner in the Health Care Consulting Services Group of Coopers & Lybrand, Chicago. He has developed and implemented a practice plan for 170 physicians, and directed organizational, operational, and marketing studies for multi-hospital systems. Pellar also has evaluated the data processing needs and capabilities for numerous hospitals. He is a member of the Hospital Financial Management Association and the American Association of Medical Colleges.*

providers of these needed services. The general economic situation in the U.S. has resulted in consumers not seeking hospitalization unless absolutely necessary and deciding against elective procedures.

Business, developers and venture capitalists view health care as a potentially lucrative profit source. Now that medical institutions are allowed to advertise, the medical system is innundated with aggressive marketing of products for profit, especially in the area of ambulatory care. The trend toward decentralization of health care is expected to continue, as evidenced by the more recent proliferation of freestanding health service facilities. Hospital outpatient services are vulnerable to competition from these centers, therefore, many hospitals are building their own immediate care, surgicenters, and freestanding and mobile diagnostic and treatment centers.

It is especially important for hospitals to expand into new markets and build satellites. Of the 221 surgery centers built in 1985, 162 were hospital based, with 284 additional centers being planned of which 196 will be hospital affiliated. A similar trend exists with ambulatory care; 159 centers were built in 1985 and were hospital-based. Medical office buildings are another source whereby hospitals can ease into the new market. They not only provide increased revenues, but can furnish improved relationships with physicians. Typically, the hospital purchases or develops a property and leases it to their affiliated physicians.

Freestanding facilities attract investors and consumers. Such entrepreneurial enterprises are easy to identify and are more flexible to market change than a large hospital. It is easier to change procedures in small facilities, and prices can be adjusted immediately to outside competition.

Convenience and low cost services are their primary advantages to the consumer. The centers may be built in convenient areas—shopping areas, suburbs, even outlot pads of shopping centers. Since such locations do not have an overhead comparable to hospitals, they are able to charge less for services. Major reasons for building a freestanding facility are to develop or protect existing markets, enter new geographic areas and new lines of business, promote to certain age or income groups, develop new sources of revenue, or respond to consumer requests.

The expansion of the health care sector is not expected to shrink despite the furor over the economy, high health care expenses, and the Medicare cost crisis. Investors favor the health industry for its growth possibilities; not for cost containment. The total capital investment required by most new service ventures is less than $3 million. Local financing becomes easier than a public offering or institutional placement of securities. Also, since venture capitalists may not be interested in a project this small, members of the medical profession become the most likely revenue source. Physicians seem responsive to ownership since it may provide additional income and a tax shelter while offering significant managerial control. Similarly, real estate investors may seek a return in the form of a tax shelter or additional cash flow. The venture typically is divided into two parts, real estate and operations. A limited partnership is most often used to finance the real estate, whereas a corporation or operating partnership normally houses the operations.

The trend to freestanding facilities already has had an impact on the building industry. In a report cited in *Modern Healthcare*, large architectural firms indicated their nonhospital health care business rose dramatically during 1980-85; from 5-10% to one-third of total health care square footage. Smaller practices, which historically have done more nonhospital health care work, reported a shift from 15-20% nonhospital work in 1980 to almost one-half in 1985. According to a survey of construction managers and builders, building activity fell 10.5% from 87.3 million sq. ft. in 1984 to 79 million sq. ft. in 1985. However, the total value of construction increased 8% from $7.8 billion in 1984 to $8.4 billion in 1985, reflecting more projects devoted to outpatient services and fewer to hospitals. New contracts for hospital construction fell 5%, in contrast to nonhospital healthcare construction which has grown 4% since 1984. The value of nonhospital construction contracts signed in 1985 increased 12% over 1984.

Construction costs of freestanding centers vary depending whether a facility is new or renovated. Rebuilding of available space is 60-75% of the cost of new construction and is sometimes as high as 85-90%. Total project costs—financial, legal and design fees, equipment—run about twice the cost of general construction.

A major concern in planning any freestanding facility is the population needed to support the center and this may vary considerably. A five-physician medical office building may successfully serve only 5,000 persons, whereas a high technology center with comprehensive services generally would require a base of more than 100,000. Most immediate care centers require a population of at least 30,000.

Types Of Ambulatory Care Facilities

Freestanding Immediate Care/Ambulatory Care Facilities

The National Association for Ambulatory Care claims freestanding ambulatory care centers are becoming primary care providers that network with each other and provide improved relationships with hospitals. Also, the emergence of HMO and PPO, alternative delivery systems, have provided contract medicine alternatives in traditional primary physician care. In a Health Maintenance Organization (HMO), an individual pays a monthly rate and receives all health care. In a Preferred Provider Organization (PPO), companies or insurance agencies contract with physicians to provide care at a pre-agreed upon rate-per-service, offering total coverage to an individual using those physicians, and only partial coverage if the individual seeks care from others. Each alternative delivery system easily may be offered outside a hospital while maintaining an affiliation for acute care.

In 1984, hospitals comprised only 10% of the freestanding facility industry; two years later, almost every hospital has considered satellite centers. Because of potential regulation problems, the early emergency care centers now are known as ambulatory care centers. Such centers dominate the market in freestanding facilities with urgent care centers up 65% and primary care centers up 27% between 1985-86.

The design of an ambulatory care center is very important. The facility should be a freestanding structure, easily visible, rather than a store front in a retail development strip. Usually between 2,000-5,000 sq. ft., it should be substantial, distinctive, and of high quality. Identical looking structures help establish an identity. The site also should be highly visible and accessible, and located on a major transportation corridor in a commercial district free of competition.

Freestanding Surgery Centers

Surgery centers are expected to increase from 330-682 facilities between 1984-88. Industry observers (AHA) believe 30-40% of all surgeries can be handled on an outpatient basis, whereas less than 2% are presently done in centers. Purchasers, particularly employers, are a major force behind the shift to outpatient surgery since it is more cost-efficient. Ambulatory surgery was covered in 96% of company policies in 1985, compared to only 35% a decade earlier. Of the 39% of the companies who provide incentives for outpatient surgery, 84% reimburse fully, while only 80% pay for inpatient surgery. Many companies apply outpatient incentives to all such procedures; others specify procedures which must be performed on an outpatient basis for full coverage.

Marketing considerations include close proximity to a hospital and the amount of available space. The closer a surgery center is to hospital-based surgeons or those in private offices, the more likely it will be used. In case of complications, close distance to a hospital is critical. Optimal size for a surgery center is between two to four surgical suites with appropriate support space of 11,000-17,000 sq. ft.

High Technology Centers

The high technology center, with highly sophisticated diagnostic and therapeutic services, might be essentially an acute care hospital without beds, or its scope of services might be limited to diagnostic, oncology, and imaging. Location is paramount in this type of facility which may have substantial equipment start-up costs. The market area must have enough people to support a 200-bed hospital. Also, many medical specialists with established referral networks are needed to support the facility, and it should be the only one of its type in the area. However, a high technology center ideally should be located near a hospital because it can expand the hospital's capabilities at minimal cost.

The center must look high tech to give an image of providing the most sophisticated service available, yet its size will vary depending on the services provided. A radiology unit averages 4,000-5,000 sq. ft. while a cardiac rehabilitation center typically runs 1,200-2,000 sq. ft.

Medical Office Buildings

A physician has many advantages in maintaining a medical office building. The facility may enhance his/her referral base, provide a better medical/professional image, offer accessibility to a wider population, and provide an ownership advantage.

Freestanding facilities increased by 52% in 1985. While

TABLE 1

Characteristics Matrix
Freestanding Ambulatory Care Facilities

	Ambulatory Care/ Immediate Care	Surgery Center	High Tech Center	Medical Office Building
LOCATION	Major transportation corridor	Proximity to hospital/ emergency unit	No similar facilities nearby On hospital grounds or close by	Proximity to hospital
SIZE	2,000-5,000 sq. ft.	11,000-17,000 sq. ft.	2,000-4,000 sq. ft.	Varies with area
DESIGN	Freestanding structure High quality	2-4 surgical suites Comfortable, warm interior	Modern high-tech appearance	Modern, prestigious
MARKETING STRATEGIES	Operate chain, using same building design	High surgical use-rate for area Young families in market area Lower cost	Look high tech, sophisticated	Strong hospital/physician referral system

medical providers are dependent upon these centers for cost reasons, such facilities must maximize their real estate investments or sacrifice opportunities for increased income; therefore, proper financing and management must be given ongoing consideration. Investors typically have utilized private sources and industrial revenue bonds (IRBs) to finance the centers.

The Role Of Consulting

In determining the success of a freestanding center there are three techniques most frequently used to assess the property's viability—preliminary market analysis, market research, and financial impact analysis.

A *preliminary market analysis* includes a demographic and competitive profile which tells whether the population is growing, provides the economic status of the residents, and identifies the competition.

Market research provides a glimpse into the future by asking consumers how they would behave in hypothetical situations. This enables developers to plan according to consumer preference.

The *financial impact analysis* examines the financial viability of a center and its impact on the parent corporation, often a hospital. Developers need to know what revenues will be lost or gained.

It is imperative to incorporate all three methods into the planning process. Mail surveys, focus groups, and telephone surveys all are useful to pinpoint the opinions held by people in the market area, and to provide the necessary qualitative and quantitative data to analyze market potential. Research is essential to define the market—that is, whether patients would use freestanding centers, what services they would prefer, how satisfied they are with existing facilities, and to identify the competition.

Demographics must be analyzed carefully. Since younger age groups are more likely to use a freestanding center, those facilities should be located in middle to upper-middle income neighborhoods where families are young and mobile. Lower income and upper income older consumers are poor targets; the former because of low profitibility potential, the latter because cost and convenience tend to be less important than physician accessibility and continuity of care.

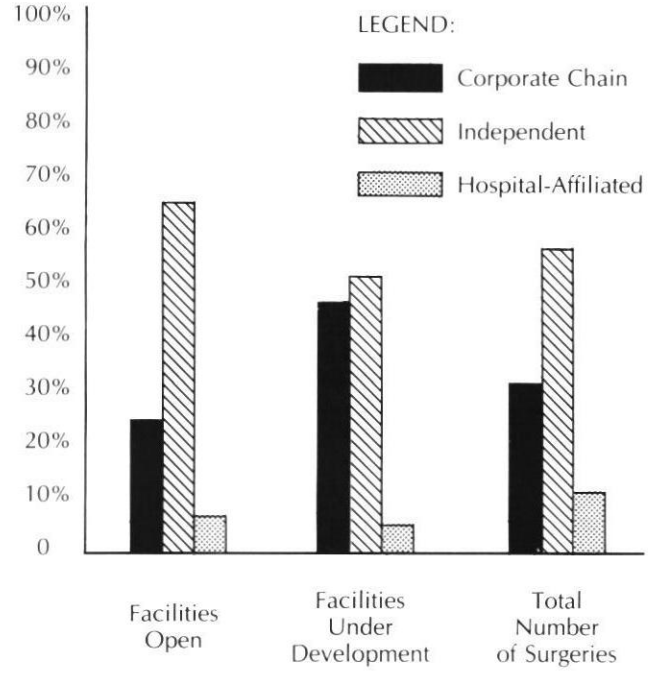
Another important aspect of market research is to determine the interests of physicians in the target area and to include them in the planning process. For instance, there is no way to estimate potential use-rates for a new center without extensive surveys of the doctors who control the demand for care. Service concepts must be presented to the physicians to determine their appeal. Furthermore, an investment analysis should be prepared to show participating physicians their investment opportunities. Capital requirements, risks, and returns will depend upon the nature of the venture. A common mistake is to select a site and plan a facility based only on national consumer research. The public's attitudes and ties to physicians can vary markedly even between markets that appear identical in demographic characteristics.

The financial analysis needs to focus on equally important issues since hospitals must consider market options. Even though the hospital may lose money when they first divert outpatients to lower costing ambulatory care centers, they can recapture it by building their own centers. Otherwise revenues may be lost to competitors with freestanding facilities who offer Medicare (which uses a fixed-rate reimbursement) or from sharing revenues with physician-limited partners. The growth of HMOs and PPOs has made it increasingly difficult for hospitals to generate revenues because they cannot provide the same low-cost outpatient services that is possible in a freestanding center.

Finally, ownership of the facility must be resolved. Full ownership is appealing because it implies maximum control but it also means maximum risk. Hospitals can reduce their risk by offering physicians limited partnerships while retaining the role of general partner. In this way, hospitals can reduce their share of debt and equity, strengthen physician relations, and minimize competition. Joint ventures typically are made between a hospital and a proprietary organization that operates a chain of centers between two or more hospitals, or between a hospital and a physician. However, physician group practices also operate freestanding facilities and compete successfully with hospital-managed centers. By developing these centers through joint ventures with

TABLE 2

Freestanding Surgery Centers
Type of Ownership



Source: *Modern Healthcare*/June 7, 1985

TABLE 3

Assessing Occupancy Options
Relative Ranking Against Criteria of Ownership

Evaluation Criteria	Capital Requirements	Time Until Entry	Financial Risk	Financial Returns	Control
Techniques					
Sole Developed & Operated	High	Long	High	High	High
Acquisition	High	Short	High	High	High
Joint Venture	Medium	Short	Medium	Medium	Medium
Contract Management	Medium	Short	Low	Low	Low
Franchise	Medium	Short	Medium	Medium	Medium
Affiliation	Low	Short	Low	Low	Low

Source: Louden & Company, American Health Care Association Journal, March, 1986.

physicians, hospitals can preclude potential competition from their own staff doctors.

Summary

The tremendous changes in today's health care provide excellent investment opportunities. As the trend continues toward more outpatient facilities, it is anticipated that freestanding centers will continue to become a viable option to traditional hospital care. However, it is important during the planning process to gain accurate information concerning the viability of a facility within a targeted market area and carefully access all the factors before making the real estate investment.

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