To Maximize Value In a Non-Profit/ For-Profit Joint Venture Think Beyond Service Line Contribution Margins

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As healthcare organizations seek to free up space within their facility or free themselves from the financial burden of noncore assets, joint ventures offer numerous benefits including higher quality care and increased profitability. To take advantage of these benefits, it's important to also understand the value of service lines before pursuing a joint venture. In doing so, you'll have a clear idea of how the asset influences your bottom line which will give you a better idea of its short-term and long term value.

Many healthcare organizations only look at the contribution margin when assessing the value of a service line. By looking at more than just the profit and loss (P&L) statement and operations, you'll be able to gain a holistic picture of your asset's value which is foundational before seeking out potential partners.

Identify the Contribution Margin, Then Dig Deeper

Service lines are rarely standalone operations. They offer services to other areas of the organization and leverage services provided by others. However, when valuing a service line for a joint venture, you need to look at how much it's worth if it were a standalone entity.

As a place to start, it's important to think about what a service line "borrows" from the hospital and what is "shared" with the hospital. For instance, a healthcare system pays insurance collectively, rather than the individual departments, so while that may not appear on as a department expense, it needs to be accounted for. At the same time, staff who split their time across service lines, often have their entire salary billed to one cost center, misrepresenting personnel expense of a department.

Eight commonly misrepresented or omitted items on financial statements in preparation for a joint venture include:

- Salaries. This includes salaries of staff that work in your department on a part-time or ad-hoc basis but their salaries roll up to another department.

- **Rent/cost of space.** The space a service line uses for its core services.
- **Utility costs.** The cost for keeping the lights on and other utilities operating, including maintenance which typically rolls up to the organizational level.
- **Insurance.** The cost to insure the space and equipment which is usually covered within the hospital's singular insurance policy.
- **Management oversight.** C-suite and leaders who oversee more than just a single department are valuable assets, but their salaries fall outside an individual department.
- **Shared services.** Central billing and collections departments and other centralized offerings that serve the entire organization aren't accounted for on the service line income statement since they're used by the whole organization. Frequently, ancillary services used by a department, such as imaging or lab, are not passed down.
- **Electronic Health Record (EHR) fees.** The cost of purchasing and implementing an EHR along with the upkeep of the EHR platform is done for an entire organization.

Beyond items on the P&L statement, other items that need to be considered into creating the full financial picture of a service line include:

- **Discretionary, one time or irregular expenses.** These shouldn't be included on a financial statement as they don't reflect the typical costs that the department requires to operate.
- **Forecast.** The forecast for the organization could provide significant added value depending on the outlook for the department. Forecasts show how a service line might increase profitability over the next few years based on trends in the market as well as hospital specific initiatives. For instance, an outpatient physical therapy rehabilitation department could increase in value if an organization recently acquired an orthopedics practices thus showing that the referral base should be strong and increase in the coming years.

Finding the Right Joint Venture Partner

Once you've firmly established the value of a given department by painting a holistic picture of all the revenue and expenses that go into day-to-day operations, one can begin to look for a potential partner.

Throughout this process, it's important to look beyond the bottom line. Identify buyers that are a good cultural fit based on the way they operate their facilities, their willingness to collaborate and thei ability to integrate with the larger organization.

In addition, consider the amount of ownership you want in the service line moving forward as well as your short-and long-term goals from the sale. While selling part of the service line offering, should increase your profit, this doesn't mean you need to relinquish all control. If it would be beneficial for achieving key strategic initiatives for you to stay involved, look for a deal where you have shared governance. Also, look at the management structure for the new entity and find ways for existing service line managers to play a role. On the other hand, if you've assessed the service line and established that you don't have the capabilities or capacity to be involved in the operations or don't have the managerial skills to lead it down a path to success, look for a partner who can take control of these aspects of the business.

By knowing the goals of a joint venture along with the service line's true value, you can align the asset in a way that will make it attractive to the right buyers. This will put you in a position where you'll not only profit from the sale in the short term but continue to drive profitable growth for years to come.

Key Takeaways

To maximize the value of your service line during a joint venture, it's important to:

Think differently.

Identify non-core or underperforming assets that could be sold to or joint ventured with a for-profit entity to free up space within your organization.

Plan differently.

Discover the true value of the service line by creating a fully loaded financial statement.

Act differently.

Identify a joint venture partner that's the right fit financially and culturally.

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