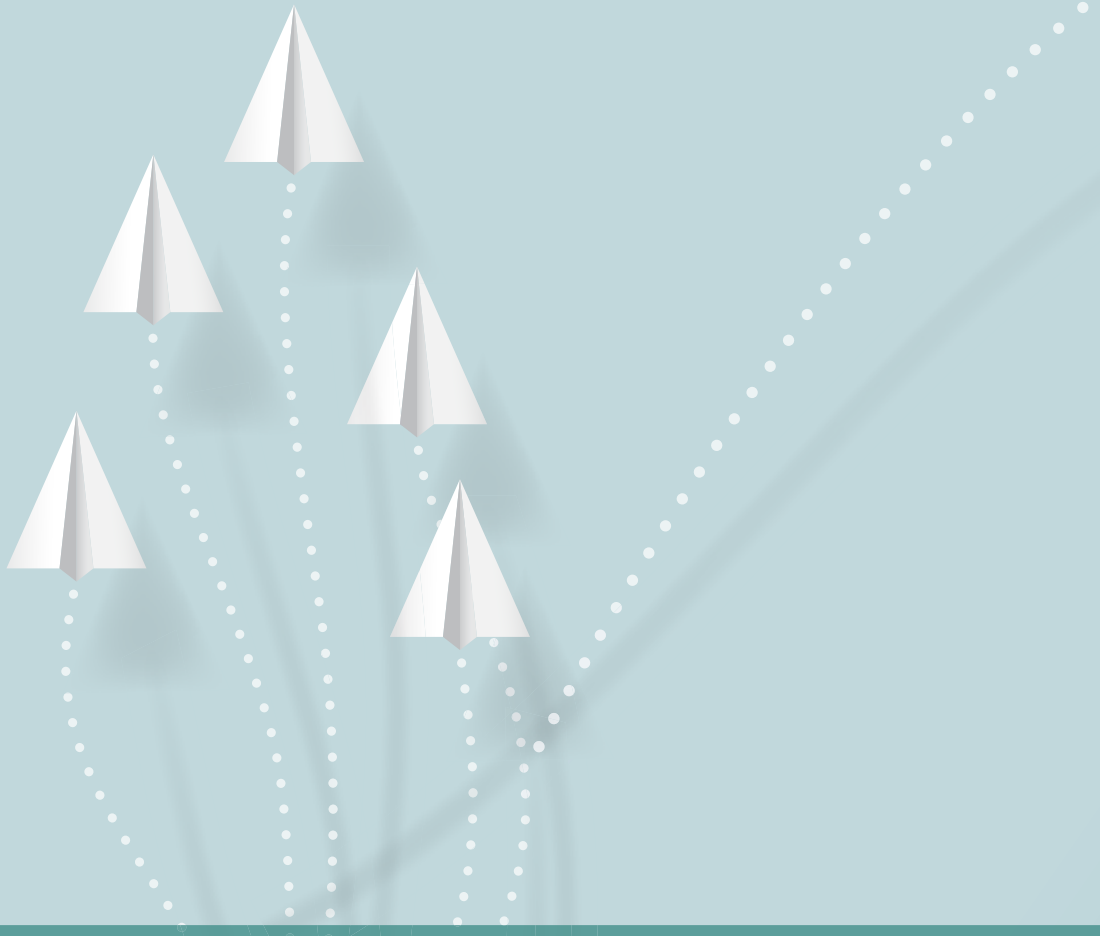
To Be or Not to Be
(An Independent Practice)
It's a Matter of Degree

Creative Alternatives to Mergers And Acquisitions

By Martie Ross and David McMillan, PYA, P.C.



Consolidation has been a trend dominating healthcare over the past few years, and there is every indication that mergers and acquisitions will continue at an aggressive clip in 2019.

Last year, hospital deals grabbed headlines due to the sheer size of some of the transactions. For example, the merger of Dignity Health and Catholic Health Initiatives to form Common Spirit Health will create the nation's largest not-for-profit hospital system once the deal closes.

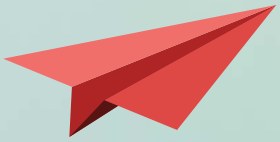
The news in 2019 also focused on newer buyers in the physician-practice marketplace. Hospitals have continued to expand their ranks of employed physicians, but private equity firms and payers are now even more in the market to acquire physician practices as well.

Independent physician practices are overwhelmed by increasingly complex regulatory requirements, continuing reductions in reimbursement, exclusion from provider networks, or the uncertainty associated with the transition to value-based payments. Many physicians tired of these challenges are intrigued by opportunities to sell their practices.

Physicians simply wanting to rid themselves of the business headaches of a private practice may seek some form of economic affiliation, which would relieve them of that burden. However, they should be mindful that it is possible to manage these challenges without ceding all control to a third party.

For example, physicians merely seeking access to value-based payment systems may participate in ***clinical integration***, joining a clinically integrated network (CIN) while maintaining their economic independence. By signing the CIN's ***participation agreement***, the physicians obligate themselves to adhere to evidence-based practices and to implement the performance-improvement initiatives outlined therein to enhance practice efficacy. The CIN may then pursue risk-based contracts on behalf of the participating physicians, absent the need to economically integrate the physicians into the system.

Nevertheless, hospital systems, payers, and other for-profit ventures remain in the market to purchase or economically align with physician practices in a continuing effort to gain control of patient populations. And physicians may still find some form of economic integration attractive.



When considering consolidation, physicians should strive to ensure that the resulting business structure allows the professionals to retain control of clinical processes.

There are various types of ***economic integration*** to consider when contemplating new business relationships, and they should only require integration to the degree necessary to achieve the physicians' goal, such as relief from some or all business concerns, access to fee-for-service contracts, or greater economic certainty.

When considering consolidation, physicians should strive to ensure that the resulting business structure allows the professionals to retain control of clinical processes. Doing so will maintain some degree of professional satisfaction and posture the practice to successfully compete in the emerging value-based reimbursement world.

At one end of the business structure spectrum is ***economic independence***, in which the practice enjoys self-determination and clinical independence but is solely responsible for securing and managing all necessary resources. At the other end of the spectrum is ***economic dependence***, in which a third party makes all decisions—be they business or clinical relationships—and enjoys the economic benefits of the arrangement, but also assumes the economic risk and responsibility for all necessary resources.

Increasing economic integration gradually alters the amount of professional autonomy of the practice's physicians. The degree of autonomy can and should be negotiated alongside the economic arrangement, to achieve a desirable balance of professional control and satisfaction within what is hopefully a more manageable business environment. Discerning and implementing this balance defines the art of designing these transactions.

The following describes different forms of ***economic integration*** other than the traditional employment model, including the advantages and disadvantages of each and the impact on the professional relationship among the physicians in the practice. Keep in mind that there are numerous variations on these generic arrangements, and each relationship must be fine-tuned to meet all parties' specific objectives.

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BUSINESS STRUCTURE COMPARISON

	Characteristics	Advantages	Disadvantages
Clinical Services Agreement	System reimburses practice a set fee for specific services (e.g., medical directorships, clinical co-management, call coverage)	Practice retains full autonomy for clinical and business operations	Practice does not receive any help with the business aspects of practice management
	Practice retains all business and clinical control	System obtains needed clinical expertise to supplement its operations	System does not receive any marketing advantage from its relationship with the practice
	System receives physician direction and control over clinical aspects of its business operations	System and practice are able to manage adherence to evidence-based clinical practices	System foregoes any economic gain from controlling patient referrals or a recognized relationship with a quality practice
	Practice receives supplemental income for services performed for the system (which may have been previously performed gratis as a requirement of staff membership)	Practice receives a predictable supplement to its revenue	
Global Payment Professional Services Agreement	System[1] contracts with practice to provide professional services in exchange for global fee payment	Physicians are relieved of the worrisome aspects of billing and collections, and physicians' exposure to rate reductions may be minimized	Practice forgoes the economic advantages of a successful business year, rate increases, or other revenue enhancements (e.g., care management, shared savings)
	System reimburses practice for fixed and variable overhead costs	Physicians receive predictable revenue from professional services	Practice relinquishes full autonomy in business-practice decisions
	Parties may form a joint-management committee to supervise their overall relationship	Practice has access to business acumen and management expertise	
	Practice largely retains control over clinical staff and operations	Physicians retain control of clinical operations, the ability to maintain adherence to clinical protocol and evidence-based practices, and the professional-satisfaction aspects of practice	
Third-Party Management Company	Independent, for-profit company (may be supported by private equity) contracts to manage practice	Practice surrenders day-to-day business operations to management company	Practice relinquishes some degree of operational and professional-practice control to management company
	Management company provides a limited menu of "packaged" services, which can range from C-suite personnel placement to consultation	Physicians relieved of business matters can focus on clinical practice	Practice must monitor management company and compliance with contract
	Physicians retain control through oversight of management company	Physicians retain control of clinical practice and the ability to monitor adherence to evidence-based protocol	Management company usually brings minimal clinical-consulting expertise
		Practice retains brand and appearance of independence	Potential conflicts arise when business operations performed by management company conflict with physicians' clinical-practice styles
			Management company is not likely to infuse capital
			Management company affords limited assistance to secure value-based payments
			Physicians must be vigilant of management company's contract obligations, and be willing to enforce terms
Member-Owned Management Company	Company is owned by the providers it manages; otherwise, it is the same as a third-party management company	Physicians delegate business operations to a physician-run management committee, freeing remaining physicians to focus on clinical practice	Practice may find it challenging to find and retain business talent
	Multiple providers must commit to organize and operate management company	Physicians retain a greater degree of control than with an independent management company	Physicians must exert time and effort in overseeing the management company
		Member-owned company is more responsive to physician-members' needs	Physicians receive minimal help with system relationships
			Physicians receive minimal assistance with additional funding or contracting

[1] In this example, we refer to the entity with which the physician practice contracts as a "system." However, a practice may pursue a similar arrangement with a private equity firm or payer.

BUSINESS STRUCTURE COMPARISON, CONT.

	Characteristics	Advantages	Disadvantages
Third-Party Owned Subscription Services	Unrelated for-profit or not-for-profit company offers contracted a-la-carte services for a set fee; otherwise, it shares member-owned subscription-service characteristics	Practices receive turnkey solutions	Practices answer to outside investors
	Relationships among subscription-services customers are few	Practices retain control	Practices must manage contract relationship with a third-party subscription company
	Operations often focus on "the latest thing"	Practices only purchase needed services	Services are often not "one-size-fits-all" solutions
	Services generally supplement, but do not supplant, practice operations	Practice receives a predictable supplement to its revenue	Practices receive minimal or no hands-on assistance
	Arrangements are generally short-term	Physicians experience minimal risk or time-drain from their professional practice	No relationship exists among members, and there is no provider network or joint-contracting opportunity
		Practices control their own adherence to evidence-based protocols	There is no infusion of capital
Member-Owned Subscription Services	Several member practices jointly own infrastructure to provide hub-and-spoke services, such as third-party billing companies, health-information technology, and data analytics	Physicians retain control of practice, and their independence	Management-member physicians compete for time for day jobs
	Member practices govern operations through a representative board comprised of member-physicians	Practices can purchase only those services needed, affording flexibility	Member practices must come to a consensus regarding expanding offerings and activities
	Professional management is accountable to the member board	Member practices determine the type and scope of offered services, based on identified needs	Member-owned subscribers are self-sustaining and have razor-thin margins
	Services are made available on an a-la-carte basis and are charged as a division of shared costs	Physicians can leverage business expertise to supplement independent practice capabilities in a non-threatening manner	A-la-carte services do not afford bargaining power
	Member practices use services as a cost-savings strategy, not as a profit center (unless services are marketed to non-member practices)	Management is delegated to employed executive staff	Membership is difficult to grow, given the risk of losing members to other forms of economic integration
		Physicians maintain adherence to evidence-based protocol within their individual practices, although a clinically integrated system can also be established among the participating practices	Arrangement results in more commiseration than collaboration
			No provider network or joint-contracting opportunities exist unless a clinically integrated system is established among the participating practices
			No opportunity for capital infusion

In pursuing value-based contracting, physicians should ultimately evaluate opportunities based on supporting infrastructure and on the strength of the clinical continuum of care.

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This is certainly not an exhaustive list of possible economic arrangements that may provide relief for physician practices seeking help with the business aspects of the practice of medicine. But the options described do offer varying levels of economic integration and relief from the headaches of business concerns, while preserving physicians' control over the professional aspects of their practice.

Health systems and other consolidators of physician practices may claim that economic integration is essential to achieving the clinical integration required to compete for value-based contracts. However, some of the most successful clinically integrated networks are comprised of independent physician practices. Also, numerous health systems have formed networks with local physicians without requiring any degree of economic integration with their practices. In pursuing value-based contracting, physicians should ultimately evaluate opportunities based on supporting infrastructure and on the strength of the clinical continuum of care. PR

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STILL KEEN ON CONSOLIDATING?
THREE KEY DEAL POINTS TO CONSIDER IN NEGOTIATIONS

If, after careful consideration, you conclude that consolidation offers you the best opportunity going forward, the following key deal points, at minimum, should be carefully considered during your negotiations with a health system, payer, or private equity firm.

1. Autonomy. In our experience, the primary motivation for physicians selling their practices and pursuing employment is their desire to practice medicine without the burden of running a business. Handing over operational responsibility, however, always means losing some level of autonomy.

For example, staffing in private practice, both clinical and operational, may vary significantly based on individual physician preferences, long-standing employees, and specific community needs. The physician's new employer, however, may require different staffing in the practice because of greater efficiency expectations or other factors. Although these changes may directly impact how the physician practices, he or she may no longer be able to unilaterally direct staffing—even clinical staffing. Generally speaking, staffing decisions are made by the one responsible for the practice's financial performance.

In anticipation of negotiations with a potential buyer and/or employer, take stock of those operational matters over which you want to maintain some level of control, such as clinical staff, patient scheduling, and referrals for diagnostic services. Be prepared to make your case for being part of the decision-making process. In striking a deal, strive to maintain a level of autonomy that ensures your professional satisfaction.

2. Compensation. Productivity-based arrangements continue to dominate the landscape, but payment adjustments based on specific performance metrics are becoming increasingly common. And more employers are considering straight-salary arrangements.

Be sure you have a complete and thorough understanding of the compensation formula before signing any employment agreement. For example, calculate future compensation based on past performance. Consider how circumstances beyond your control could negatively impact compensation (e.g., the health system's decision not to contract with a specific payer) and negotiate for safeguards to protect your interests.

If an employer proposes to tie some compensation to quality performance, ask questions (and demand answers!) regarding how the metrics are selected, how data is gathered and evaluated, and whether your patients' acuity levels are considered. Also, understand how often, and by what process, performance metrics are evaluated and recalibrated.

Carefully consider the benefits package offered by the employer, including insurance coverages, vacation and sick leave, and expense reimbursement. Evaluate how the compensation package compares to the overall market. A valuation expert can provide the data and analysis needed for such comparison, thus strengthening your negotiating position.

3. Purchase price. You can significantly improve your negotiating position by securing the opinion of a valuation expert regarding the value of practice assets. Otherwise, your options will be limited to nit-picking the potential purchaser's valuation. As necessary, determine whether the purchaser will honor previously negotiated ownership buy-outs and retirement planning.

Determining fair market value, understanding the underlying approaches and application to your practice, and looking ahead to the impact of a future compensation structure—and its potential effect on the practice valuation—are all important economic principles that a buyer will consider. Physicians who take the time, and make the effort, to dig into this information before the transaction negotiations begin may save themselves, their partners, their employees, and their legal counsel significant heartache, frustration, time, and expense.

The circumstances of every deal are unique, but focusing on these three deal points—and making sure all questions are adequately answered prior to signing on the dotted line—significantly increases the likelihood that consolidation will be beneficial to all parties. (PR)