Physician Practice Mergers: 
The Importance of Due Diligence and Mutual Trust for All Involved 

Focus paper submission 

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Introduction

The future of physician medical practices will depend on the willingness of smaller physician practices to successfully merge or determine that joining a large health care organization would be the best business decision to ensure viability. Due to the constant changes in reimbursements and government relations, mergers of separate groups into larger groups, health care organizations, or larger independent practices will be more prominent. A complete and in-depth analysis should include, for all groups, operations, financials, compensation, governance, risk and benefits, technology, marketing, and branding. This paper will explore all of the aforementioned areas as well as the additional steps that need to be taken to ensure a successful merger. To assist the medical practice’s leadership and physicians that are looking into the possibility of a merger, this paper will also discuss aspects that should be avoided if the merger is to be a success including but not limited to risk, inefficiency, dishonesty, and lack of communication.

The research methodology of this paper will be from published books, and articles, as well as cited online publications. All sources will be in the reference section of this paper.

The purpose of this paper is to highlight the significance of performing due diligence during analysis and maintaining mutual trust for all physician practices and health care organizations during a merger. It is imperative that all the pros and cons of each option are explored including merging into large health care organizations or larger independent physician practices.
The dramatic changes in health care are fraught with uncertainty. As health care submerges further into managed care, physician practices will struggle to survive and try to avoid mergers and acquisitions. Yet in today’s rapidly changing environment, more groups are finding to stay in business, they must make tough business decisions that will affect the physicians, health care administrators, staff and patients. Merging independent medical practices into health care organizations, larger groups, or larger independent practices is becoming a common strategy for dealing with government regulations and physician reimbursement.

In spite of the benefits of mergers and acquisitions, an analysis of the risks, needs to be completed as well, so that the final decision on merging or being acquired will be made based on complete and accurate information.

**Areas of Pre-assessment Before Final Decision**

**Type of Entity**

The first key to success is determining what type of entity the new practice will be; a hospital-owned practice or part of a larger independent physician practice. According to the 2008 article, *Is your practice merger doomed to fail?*, Peter Valenzeula explains if practices choose to merge, the options are a general partnership, a limited liability corporation, a limited liability partnership, or a professional corporation that is either an S or a C corporation.

The major factor to consider when choosing a practice entity is how it will be taxed, according to the 2005 article, *Choosing the right practice entity*, outlined by Jeffrey Sansweet. Financial implications and liability protection must also be considered. Although there are obvious pros and cons for each type of entity, including individual taxation, interest and penalties, better retirement plan options, and net income passed on to the owners, health care administrators should consult with qualified attorneys and Certified Public Accountants (CPA)s during the process.
During negotiations and fact-finding—and to determine which type of entity should be chosen—it is imperative that all parties are transparent about financials, past lawsuits, malpractice cases that are outstanding, bankruptcies, and claims against the practice or individual shareholders.

If a practice chooses to be acquired by a larger hospital corporation or independent physician practice, the entity type is typically determined by the larger organization. In this situation, physicians typically become employees of the corporation and are paid a salary based on their productivity or they are given a predetermined compensation that has been agreed to.

**Practice Assets and Debts**

Areas of importance that should be assessed during the decision-making process are individual assets, liabilities, the finances of the physicians, and the overall practice debt. Historical data should be analyzed as well, such as overhead, expenses, charges, reimbursements, collections, and adjustments. In some instances, these finances should be contributed to the new group. Medicare participation is one of the most important decisions that must be made during merger discussions, especially when the merger involves a small physician practice, as cited by Reed Tinsley in his 1994 article, *Merging Medical Practices: Look before you leap*. Not all physicians accept Medicare. How many participate in each group? How many do not? It is imperative that both groups come to a mutual agreement because they will all have to operate the same.

Debts that need scrutiny are individual physician debts, overall practice debt, accounts payable, and any outstanding lease obligations. Whether the debts are current, overdue, or have been paid inconsistently, will be a key indicator of how that physician or practice handles their finances.

In 1994, Tinsley said that hard assets should also be assessed, including real estate, equipment, investments, stock, and cash. According to the 2018 MGMA article,
Cristy Good states that copies of leases, appraisals, property titles, medical contracts, and payer-participation contracts such as Medicare or Medicaid should be presented to all interested party’s attorneys during the assessment process. These documents will help to determine the actual value of a practice.

**Physician Compensation**

Physician compensation needs to be addressed at the start of merger or acquisition negotiations. When deciding on compensation, many areas need to be discussed and agreed on. If this is not done, different opinions on how the physicians should be paid could cause a merger or acquisition to fail. Transition provisions may be needed to cushion a short-term drastic change in compensation, such as when physicians are acquired by a large health care organization or independent physician group. Often times there will be a decrease or stall in payment during a transition of this magnitude. Is there a partnership track built into the new agreement? Is there a bonus structure included in the compensation model for ancillaries? Is the formula based on productivity of a percentage of collections? All of these important issues should be explored, discussed, and agreed to.

According to the health care attorneys, Mathew Levy and Stacey Marder (2018), it is imperative when evaluating whether to move forward with an offer from a large health care organization or large independent medical group to look at the offer from a business perspective. When these two organizations approach a physician group, they will entice the physicians with their ability to offer better reimbursement rates and often higher salaries. Physicians should do their homework to ensure they are being offered the best and most accurate reimbursements. It is appropriate for the physicians to request a copy of the top 10 Current Procedural Terminology (CPT) billing codes used in the practice or in the hospital. In addition, physicians should consider how to move forward with an offer if a physician is being compensated based on a percentage that does not
include ancillary services or diagnostic testing. For a specialty that is primarily diagnostic testing or labs, the actual compensation might be considerably lower than originally presented.

**Clinical and Administrative Personnel**

According to the article in 2005 by Daniel Bernick, *Key issues in merging medical practices*, it is challenging to assess a merger of two small physician practices because, typically, their resources are duplicated, and they will need to determine which resources to retain. For mergers involving hospitals or large physician groups, staffing in most cases will remain intact until otherwise determined unnecessary. In the beginning stages of the operations of a merger or acquisition, all employees will be needed to ensure that the transition process goes as smoothly and seamlessly as possible. However, during this time, key administrators should create a list of all employees with position titles, status, compensation, benefits package participation, and any special circumstances (i.e., Family and Medical Leave Act (FMLA), military leave, maternity leave).

The agreements with providers, administrators, W9 employees, and contract vendors should be reviewed and adjusted and agreed on because this process can often lead to combined contracts that result in better rates through group purchasing.

Once all agreements and contracts have been reviewed, a practice administrator should be chosen for the new entity. It will be that individual’s sole responsibility to determine what clinical staff is necessary and what other administrative staff will be needed to run the business operations of the practice. In addition, he or she will establish the new fringe benefits packages, new policies and procedures, and job duties and responsibilities as well as work with physician leaders to maintain a patient-centered, best practices-based physician group.
Facilities

One or more locations may close or consolidate because of the merger or acquisition creating one main location with satellite offices. When two or more facilities are involved in a merger or acquisition, all Health Information Management (HIM) requirements should be reviewed to ensure compliance with state licenses, regulatory requirements, accrediting standards, and Medicare conditions of participation (if applicable). Some locations could be closed if they are not in compliance.

Key facility items to be considered are certificates of occupancy, property agreements, insurance, fair market value, and accessibility. In an acquisition, the hospital or larger group will often buy out the owners of the building or move the group to a hospital-owned facility. This way the hospital can guarantee compliance without a financial burden on the physician practice.

Governance

Merging or allowing an acquisition is an act of faith in today’s ever-changing health care environment. Bernick (2005) emphasized that physicians must trust that they can get along with their future partners and the management teams involved in the acquisition, which is why stakeholder buy-in is detrimental to success and a strong managing physician is needed to ensure a successful merger or acquisition. This physician must manage the practice efficiently and effectively by following predetermined duties and responsibilities.

A structured governance document that includes compensation and by-laws is also essential before the merger or acquisition is completed. Several questions should be decided upon for the governance document: Will there be a board of physicians? Will there be compensation for the managing partner and board? What are the board positions and terms of each position? Will the physicians who are not on the board but part of the merged entity be allowed to vote on major decisions, or will decisions be by a majority
vote of the board? Any future disagreements can be diffused simply if these issues and solutions are in a governance document.

**Operational Policies and Procedures**

Operational policies and procedures are instrumental to the success of any merger or acquisition. There must not be an interruption of, or decline in, patient care at any time during the transition. Although learning curves associated with transitions of such magnitude will be unavoidable, minimal interruptions will occur if employees are trained in the operational policies and procedures that have been established. A company that is acquired will typically adhere to the already established policies and procedures of the acquiring company. Occasionally there is room for negotiation depending on the persistence of both parties.

Operating independently should be avoided because it can cause disconnects in restructuring efforts, increased costs, and an inability to share in cost-saving opportunities as well as undermine a goal of the merger or acquisition. Operationally speaking, the new entity should have a shared cultural overall view of a medical practice in order to avoid complex workflow issues. As Austin Kirkland stated in his 2014 article, *3 pillars of success in practice mergers*, “a merger between two groups that is not a good fit is when one group is more concerned with quality and the other group is more interested in volume.”

Operational issues may arise in other areas and will need to be resolved before moving forward. These issues often include call schedules, office and surgery schedules, electronic medical record systems, ancillary equipment, fee schedules, office hours, and a name for the new entity. A multitude of hidden issues and operational procedures, ranging from selecting the office telephone number to who the malpractice carrier will be for the group, will need to be considered and analyzed. Many decisions for the acquired
entities will often be beneficial financially and operationally. Creating a prominent strategy for dealing with operational issues should be part of the planning process.

**Retirement Plan**

Mergers generally mean the adoption of a single retirement plan. Physicians must agree on the terms of the new plan, which can be the same as or different from the preexisting plan. Another option might be to develop a completely new plan that is separate from any preexisting plans. Bernick (2005). Once the terms of the retirement plan is decided, the accumulated assets can be moved into the new plan without a tax penalty. Well-qualified, highly trusted plan administrators and investment counselors should be consulted on all plan decisions made during this process.

Because of the expense of retirement plans on small physician groups, some physicians are hesitant to participate and do not want to be forced to do so. This can be an attraction of a merger or acquisition that will allow those physicians to participate who would not otherwise.

**Physician Contract Issues**

Physician contract issues can make or break a deal if they are not resolved quickly. Whether there is an issue with the physicians and a health care organization, a large independent physician group, or two practices merging, it is important to agree on a few key areas regarding physician contracts. Bernick (2005) recommended sidestepping the equalization dilemma by providing a provision that if one party contributes more equipment than the other, it will be reflected in any future buy-out. So if a physician who contributed less equipment leaves a group, he or she is not required to make up the difference with cash; his or her buy-out would be smaller than that of the physician who contributed more equipment.

Tinsley (1994) recommended considering four main buy-out issues: (a) retirement, (b) death, (c) disability, and (d) voluntary or involuntary withdrawal from the
group. For each issue, the larger organization, along with the physicians, must decide when the buy-out will occur, how the buy-out amount will be calculated, and how it will be paid.

Non-compete provisions cause unease and deter physicians from moving forward with a merger or acquisition. As a result, the terms should be discussed at length, mutually agreed on, and applicable to all (or no) physicians equally. This provision can be added at a future date when the physicians are more confident in the process and outcome of the merged group or acquisition. A less restrictive provision might be a financial limit on any future buy-outs, meaning if a physician decides to leave, he or she would be allowed to compete but would be obligated to pay to do so. This motivates the physician to stay with the group, but it does not feel as binding as a non-compete clause.

To eliminate any jitters a physician may experience during a merger or acquisition, it is important to include in a physician contract a bailout clause or a merger withdrawal agreement. Typical bailout provisions include the allocation or handling of patient lists, charts, phone numbers, leaseholds, staff, equipment, and corporate name and entity. Bernick (2005). These provisions can last from 1 year to 18 months and allow a physician to withdraw during that time with a minimal penalty or to accept a predetermined buy-out offer.

**Legal Framework**

Section 7 of the Clayton Act “prohibits mergers and acquisitions where the effect may be substantially to lessen competition, or to tend to create a monopoly.” The first priority during a merger or acquisition is to avoid violating this act, to know and understand antitrust laws, and to minimize antitrust risks proactively through professional counsel; however, counsel and clients must be conscious of the risks of sharing information with a competitor before and during merger or acquisition negotiations, a concern that remains until the deal closes, according to the 2018 article by Holly Vedova,
Keitha Clopper, and Clarke Edwards. Entities that pursue mergers or acquisitions must share certain information, but when they are already competitors, each party must pay special attention to the information shared in order to avoid unreasonable information sharing that could cause harm to other competitors possibly putting the competitor out of business.

Once the legal framework for the new organization has been established through antitrust legal counsel in accordance with the Federal Trade Commission Act and antitrust laws, managing risk is the key to avoiding it. Setting up policies and procedures to monitor and control shared information (as well as auditing) will avoid the misuse of information or appearance of misuse. Vedova et al. (2018) stated that antitrust counsel can prevent problems with information sharing. First, all interested parties should be certain that the legal framework, maintenance, and auditing protocols will prevent information-sharing problems, especially during beginning negotiations. Second, all interested parties must follow protocol. If it is learned that information is being shared, counsel should stop all activity and report it to the Federal Trade Commission for further legal action.

**Pillars of Success**

Medical groups considering mergers or acquisitions will learn that the stakes and investments are higher than they were just 5 years ago. The pressure for financial returns, competitive advantage or market dominance, specialization, leverage, and patient volume is challenging for small, independent groups. Frequently, as the health care industry evolves, these small physician groups can no longer remain independent. Regardless of the potential for exponential economic and strategic returns, which might not be realized until after the merger is finalized, three essential factors can make the returns possible. Many times, they are more valuable together than they are separate. The three essentials are stakeholder buy-in, physician leadership, and a shared culture. Kirkland (2014)
**Stakeholder Buy-in**

Although everyone that works in a company is a stakeholder, the stakeholders pertinent to stakeholder buy-in are managing partner(s), directors of the board, and physician leaders. These individuals represent all levels of the organization. If this fact is apparent throughout the process and communication is open, honest, and transparent, ensuring positive morale, then there will be management and staff buy-in. Mutual honesty and respect are important when charting unknown territory, and they will prevent unrealistic expectations of economic returns.

**Physician Leadership**

Physician leadership is instrumental in a successful practice and especially so during a merger or acquisition. According to Kirkland (2014), a practice cannot exist without a capable physician leader who has name recognition outside the group and human capital inside the group. It is important that the most qualified physician be selected for the position and that there is a succession plan. Physician leaders who work with health care organizations or large independent groups need strong leadership skills and the ability to follow best practices that benefit the group. In a merger, typically one physician leader will take a secondary position but will work closely with the leader through the transition and thereafter. Strong physician leadership is one of the main reasons mergers thrive. Kirkland (2014)

**Shared Culture**

A shared culture sets the tone for the overall environment during a merger or acquisition. Because combining cultures (small or large) is a complex process, it is important that all parties are like-minded. Physicians bring to the table both positive and negative attributes that can affect the outcome because they are the key players in the game. Both positive and negative attributes are fine as long as their ideas about a medical practice are the same. As mentioned above, Kirkland (2014) concluded that if one group
is about quality and the other about volume, the result is a poor fit—dissimilar cultures cannot be overcome.

**Avoiding Missteps That Lead to Failure**

According to the 2012 article, *How to avoid missteps in medical practice mergers*, George Conomikes stated that the first consideration in merger or acquisition planning is determining whether the merger or acquisition is feasible. Are the physicians compatible? If they are not compatible, regardless of the due diligence, analysis, pre-assessment, and so on, the merger or acquisition will not be feasible and will automatically fail. If the physicians cannot agree on the legal framework for governance, compensation, policies, and procedures, then the merger or acquisition should not proceed. If the physicians are compatible, the merger or acquisition is feasible.

Another mistake made during a possible merger or acquisition is taking shortcuts to close a deal before it fails. The parties want to quickly get the most out of the deal before something happens and the deal falls through. This rush can cause information to be missed in the evaluation process that highlights the benefits of the merger and not the possible tradeoffs.

Mergers and acquisitions tend to fail for three reasons: (a) Considerations are limited to valuation rather than evaluation due to the limited information received. Questions should be asked to better evaluate the pending deal, including the following: What is the culture? What are the goals of the parties? How does each organization practice medicine? (b) Financial projections may show the benefit of being associated with a large organization, but they often fail to address the downside. The large organization has new liabilities and burdens financially imposed on it. One example that is most obvious is the Family and Medical Leave Act. This law does not affect organizations with fewer than 50 employees, but a new organization often has more than 50 employees. Employee benefits packages tend to be more substantial in large
organizations, which results in higher costs for employers as well as employees. Often any ancillary money will be lost as well with any affiliation. And (c) the smaller organization and its leaders will consistently underestimate changes to its modus operandi, which is evident when a smaller practice joins a larger organization or group, according to Carol Stryker’s 2013 article, *Three reasons why medical practice mergers, acquisitions fail*. Employees with small organizations are used to having autonomy and running daily operations as they see fit, but as part of a larger company, these employees have fewer choices and often have no autonomy and no choices or input. Several of the most difficult factors that a physician may deal with are the bureaucracy and the long time frames associated with human resources as well as financial and operational issues. These changes and delays in time should be explained beforehand to avoid surprises, which can make matters worse. On the one hand, losing autonomy is abysmal because someone you may not trust completely is making decisions on your behalf whether you agree with them or not. On the other hand, physicians benefit because they have no responsibility if a decision is poor, which means the costs are the responsibility of another, larger company that possibly has deeper pockets.

**Lessons Learned**

During a merger or acquisition, many lessons are learned, both good and bad. Some of the important lessons learned during the process for a practice administrator that should be kept on the radar at all times are:

- Never allow yourself to be excluded from meetings involving key decisions about your practice.
- Seek legal, financial, and regulatory advice and have official written documentation of that advice.
- Explore all options, small, medium, or large, and never rush through the process or overlook the details.
• Be transparent, truthful, and honest to build confidence.
• Ensure physician compatibility.
• Allow physicians to maintain a sense of autonomy.
• Keep employees involved and informed regularly, within reason, to obtain their buy-in.
• Choose physician leaders wisely.
• Practice due diligence and carefully compare the pros and cons of all options with the assistance of counsel.

**Conclusion**

In the last decade, there has been a consistent uptick in the number of medical groups merging with similar size groups and selling out to larger health care organizations or larger physician groups for a variety of reasons. The offers can be appealing to physicians when simple and fundamental information is given, but not the hidden details. The long-term success of a merger or acquisition depends on the time, effort, and true motivation exerted by all parties involved.
References


