

Succession Planning in a Single Owner Physician Practice

Case Study

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Introduction

The practice is a sub-specialized reference facility that works across the United States and has been in existence for 15 years. During that time the practice grew more than the owner, a practicing physician and sole owner of the practice, ever imagined it could. It had attracted the brightest names in its field and was now widely regarded for its expertise. Due to the success the owner was becoming busier than he had been at any other time in his career and, despite his age, retirement was the last thing on his mind. His work volume was increasing, he was launching new initiatives, and branching out into new areas. By late 2014, this pace as well as some personal priorities had begun to cause him to reflect on his future plans and what would become of the practice that he had built.

At this time approximately one half of all physicians are over the age of 50 (Scroggins) and our owner was no exception. Also like our owner, most physicians are just hitting their professional peak by this age becoming increasingly busy rather than less so. Perhaps they have become partners in their practices, they most likely have a well established patient or client base and have built reputations that make their opinions sought after. It is easy to minimize the importance of succession planning when retirement, a term synonymous with old age, seems so far away.

However, retirement is not the only reason to have a plan. As we all age we become more susceptible to health problems that could take us out of the work force or greatly reduce our abilities to perform at the capacity we are accustomed to. While it may be easy to dismiss this possibility, especially if the individual is healthy, accidents can happen to anyone without warning. Failure to create an effective succession plan can result in disastrous consequences, destroying everything that a physician has worked so hard to build. And it is not just calamitous for the physician. When you stop and consider all of the individuals, patients, employees, and partners, who are dependent on a physician the importance of this type of planning begins to set-in. It is especially important in an organization that has a sole owner such as our practice.

The owner was at a loss for how to proceed. He was unsure about how to approach the issue, who could help guide him in developing a plan, what was typical in a succession plan, or even where to start when developing the plan. He had discussed these problems with the administrator several times in the past but had not been prepared to take the plunge and commit to developing a plan. In early 2015 that would change and the administrator was asked to start making arrangements to develop a formal plan. The administrator was happy to hear about this development but quickly came to realize that the owner viewed this as just another business issue and preferred the administrator handle things rather than he himself being involved. The administrator emphasized the importance of the owner's input in this process. After all, it was his company alone and only he knew what he wanted for the company in the future and what he himself wanted from the company following his exit. He acknowledged his role and it was decided that the administrator would assist by locating a qualified consultant and working with the consultant to come up with a preliminary plan that could meet all of the owner's expectations. Once the administrator was satisfied with the plan the owner would meet with the consultant and additional changes could be made. In this way the owner got to focus on practicing medicine but remained the final decision maker for the plan.

To start, the administrator discussed what the owner viewed as the most important results of the plan. The most important thing that the owner wished to achieve was the security of the staff. He had spent 15 years developing a practice built around appreciation of its employees from entry level positions to the senior physicians. Without the staff the owner knew the company could never have become as successful as it was. He did not want anyone to acquire the practice and lay off staff, cut salaries, or significantly change the culture of the practice.

Secondly, he needed the eventual sale of the company to bring enough revenue to support him and his family for the remainder of his life, preferably with some inheritance left for his children. The owner had invested a significant amount of money into the company and it was,

expectedly, his largest investment. When it came time to leave the practice he needed to achieve a return on that investment.

Lastly, the owner needed to establish stability in the practice. Successful single owner practices generally become successful due to the drive, vision, and hard work of the owner. However, the dysfunction of this is that the organization can become synonymous with the owner creating a dependency that can create problems. The practice had already begun to see this first hand with difficulty recruiting young physicians. The recruits were understandably concerned about the future of the practice. What would happen if something terrible were to befall the owner? Would the practice survive? Who would take over? Many could not bring themselves to relocate their families and leave the relative security of a hospital or academic setting that was not dependent on a single person for an independent practice. As a result, the practice was successful in attracting older physicians with excellent reputations but it became clear that the practice needed to attract younger physicians if it was going to be able to meet the growing demands of the practice over the next 10 to 15 years.

On a similar note, the owner needed to assure the younger physicians who were on staff that they would be secure in the practice. Many had questioned over the years how the practice would proceed if something were to happen to the owner. The owner viewed these physicians as the future of the practice yet they didn't know what that future would hold for them. The owner also feared that if something happened to him, without a plan, the practice would be in such disarray that the physicians could engage in disputes over decision making creating a poor working environment, poor service to the clients and their patients, and eventually the death of the practice.

It was also important that the owner assure the practice's clients that it was stable. The clients relied on the practice for rapid turnaround on patients who were very ill, some of whom had transplants that may be in jeopardy. If they could not be confident that the practice would perform consistently they would find another reference facility. Even one slip up could be enough

to be remembered by a client for years due to the high stakes involved in some of the cases. Frankly, the clients would not abide poor performance regardless of the cause and the owner knew that he had to assure them that the practice would be capable of meeting their needs no matter what happened to him.

Alternatives Considered

Once the administrator knew the specific goals and concerns of the owner they began discussing possible scenarios. The first was to do nothing at this time. The owner was in good health and planned to work at full capacity for the next ten years. He had successfully grown the company and there was no reason to believe that under his leadership the next ten years would be less successful than the previous ten. The company could continue with its current processes and enjoy the continued growth.

Clearly, this alternative had its drawbacks. The owner knew that for reasons both professional and personal, he had to ensure that the future of the company was stable and that everyone, both internally and externally, knew the company had a plan to continue without him. He also knew that the practice needed new physicians if it were to be successful for even the next ten years. Without a plan, recruitment of these physicians would continue to get more difficult with each passing year.

Next, the practice could try to sell to a larger company. The practice had achieved a considerable size and, as a result, was expected to be worth a considerable amount of money. It was not expected that anyone, including a regional provider, would have the means to acquire the company. It would take a large national healthcare corporation to be able to invest the money that would be required.

Furthermore, being brought under the umbrella of a large corporation could create opportunities that heretofore were unavailable. It could be possible to execute preferred provider agreements with insurers and to negotiate with whole health systems rather than individual

hospitals. Both of these would continue to increase the practice's market share and ensure a productive and profitable future.

While this alternative could provide sufficient revenues for the owner to retire comfortably and have a positive effect on the practice, it also carried some significant risks. First, a sale could not be guaranteed and even if a large company was interested, there was no guarantee that they would be willing to pay what the owner expected or needed. If the owner was retiring he could be flexible about the time needed to find an owner and negotiate a deal. However, if his departure were unexpected the practice could be thrust into chaos and other companies would almost certainly take the opportunity to acquire the practice at a cut-rate price.

Secondly, acquisition by an outside entity would almost certainly result in major changes within the practice. The new owners would certainly evaluate every facet of the practice in order to see which areas were consistent with their business plan and discard anything that was not. This could mean services, staff, or even facilities could be terminated or liquidated. The owner had heard horror stories about corporations acquiring small independently owned companies only to move the operation into their existing facilities leaving the staff that wasn't laid off to make the decision to relocate or be put out of work. This was a scenario that the owner desperately wished to avoid.

Lastly, the owner could sell to physicians within the practice. This had the potential to be the least disruptive internally and externally. The new owners would be known to the employees and to the clients. Additionally, the new owners would have firsthand knowledge of the practice, its mission, its vision and its values.

The owner was very attracted to this option for the stability that it could provide. Yet, even this option had considerable hurdles. First, the value of the company could be an obstacle. It was unlikely that any single physician would be willing to take the risk and purchase the company and in reality it would likely require at least three physicians to partner on the purchase in order to make it financially feasible. Even then, the owner would likely have to provide a

significant discount to make this option feasible. This partnership would create a new dynamic in the practice which had not previously been present.

Next, due to the difficulty in recruiting younger physicians, nearly half of the physicians were also approaching retirement age. They would not be interested in making risky investments at this point in their career, rather they were trying to protect their assets. Many of the young physicians were very early in their career and had not been privy to any management discussions within the practice. They could be reluctant to invest such a large sum of money into the practice while feeling very unprepared for the duties associated with ownership and management.

Lastly, there were no guarantees that even physician owners from within the practice would retain the practice in its current form. The owner had been the sole decision maker since the inception of the company. It was not clear whether the rest of the physicians fully supported his management decisions or not. Furthermore, when the practice revenues were split between multiple owners it was possible that the existing economics would not provide the type of return on investment that would be needed. In this case they would be forced to look for ways to reduce expenses.

Procedures Used to Select a Solution

With the most obvious alternatives laid out, the administrator suggested that the owner solicit some feedback from the physician leadership team. The owner had recently established a group of physicians to serve as leaders for the practice. Each had an area of expertise, such as regulation, business development, or clinical issues. They assisted the owner in making decisions within the practice. Therefore it made perfect sense to begin with them. The discussion also served to make the process transparent and most importantly to make it known that the practice was putting a plan in place.

The discussions with the physician leaders yielded several conclusions. One, many of the practice physicians had been concerned about the lack of a plan but were reluctant to vocalize this to the owner. They acknowledged that at least one physician that had been the source of

recruitment efforts had made their decision not to join the practice due to fear that the practice would not continue without the owner. Therefore, each was adamant that the option to delay action was not an option at all. Finally, they were each opposed to selling to a larger company. What had attracted them to the practice was its independent nature and they felt that becoming a small part of a large organization would jeopardize that autonomy.

Since neither the administrator nor the owner had any experience with succession planning and because there were a number of legal considerations involved it was decided that the practice should retain a consultant to assist with the plan. The practice retained an attorney with a considerable amount of experience with mergers and acquisitions across a broad range of industries as well as consulting on corporate governance issues. The hope was that the attorney could advise the owner on how best to structure his plan to avoid pitfalls and ensure a smooth transition that would benefit everyone.

Decision

With the feedback from the physician leaders and the guidance of the consultant the owner was ready to make a decision. It was determined that the option to sell to the practices physicians would be the best alternative. Furthermore, the consultant felt that this arrangement could provide the least disruption to the practice and the greatest benefit to the owner. The owner and administrator met with the consultant a number of times to finalize the details of the plan. It established procedures for what would transpire in the event that the owner passed away unexpectedly in addition to how the sale of the company would be handled when the owner was ready to retire. It was decided that the owner would retain management control of the company for a period following the sale in order to allow the new owners to become familiar with the business. It would also give the practice's employees time to become comfortable with the new ownership dynamic and allow the practice to present a decentralized group to the practices clients.

Implementation

With the details in place it was important to communicate the basics of the plan to the practices physicians. The physicians were informed first as the eventual owners would come from this group. This allowed them to have assurance that the practice was stable and also to begin considering the possibility of investing in the practice themselves.

For now, the owner still plans to practice full time for the next ten years. However, the practice's physicians can be assured of the stability of their positions and those who are interested in purchasing the company can begin making plans and reviewing the feasibility. Furthermore, the practice can now calm any fears that new physician recruits may have about joining the practice.

Lessons Learned

Regardless of the governance structure of a practice and the age of the owner or owners, a succession plan is of the utmost importance. Yet, when a practice has a single owner it becomes absolutely critical, especially as the owner ages. Discussions about retirement and death can be uncomfortable, to say the least, especially if the owner(s) plan to continue practicing for a considerable amount of time. However, it is important to realize what could happen if something unexpected were to occur. Regardless of the difficulty of the conversation most owners could not bear the thought of the practice they had built crumbling due to a simple lack of planning. Therefore, every practice should have a succession plan in place to hedge against any situation.

Next, the owner(s) must establish clear goals for the plan. If the owner(s) are young, perhaps the plan should only outline what happens in the event of an untimely death for the time being. If the plan involves selling the practice the owner(s) should know what they want from the transaction as well as what they wish to avoid. It is also important to understand that it may not be possible to achieve all of these things. By definition, selling a company means that the previous owners will not have the control that they are accustomed to. Making these goals known, however, will allow for a discussion on what is and is not possible. In this way, at the least, the owner(s) will know what to expect.

Finally, this subject is deeply personal and effects no one in the way that it will effect the owner(s). To that end, the owner(s) absolutely must make the final decisions. Administrators have an important role in supporting the decision making process, identifying qualified consultants and, investigating potential issues but the owner(s) must own the plan in the end. This may seem obvious, but some sole owners may look at this as one more administrative task to be handled like all other business management decisions. Physicians are used to making quick decisions and taking action. This is one area that demands detailed discussion and time to evaluate the pros and cons of each possibility.

Conclusion

The practice's sole owner had been so concerned with growing the company that he had not even considered what would become of his life's work if something were to unexpectedly happen to him. Furthermore, he was ageing and the unrelenting pace of an ever expanding practice was beginning to make him think of retirement. Yet there was no plan for this either. To begin, the administrator and owner outlined what the owner wished to have happen if he were to die or when he was ready to retire. Once we knew what we were trying to achieve the practice retained a consultant that could advise on how to best structure a plan to achieve these goals. It was decided that the owner wished to sell the practice to physicians in the practice in order to retain stability and culture. With the details in place the physicians were notified so that they could rest assured that a plan was in place and, for those interested in investing, begin investigating the possibility of ownership. Now that a plan is in place all practice staff have more confidence that they will have a job for years to come.

References

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