Every shift in the national approach to reimbursement or healthcare legislative status quo drives a change in the composition and operations of medical groups. The general thrust is to form either specialty specific or multi-specialty collaborative organizations in order to take advantage of economies of scale. The trend has favored formation of larger groups. In 2008, 56% of physicians were full or part owners of their practice. From 2001 to 2009, there has been a 16% decrease in solo (self-employed) surgeons and a 35% decrease in two surgeon (self-employed) practices. In a recent report by Irving Levin Associates, merger activity jumped in the second quarter of 2012 with 21 practices reporting merger/acquisition activity involving $4.2 billion.

Failed mergers/acquisitions are usually the result of inadequate preparation. This practice memo is intended to aid vascular surgeons contemplating or in the process of a practice merger/acquisition with the business questions and decisions involved in the process.

Key Merger Steps

Analysis of factual, not fanciful data, by the leaders of the merging organizations is critical. The organizational boards involved in a merger/acquisition discussion must provide leadership related to analysis of the facts by asking financial and legal advisors the correct questions, as well as conducting oversight of the process. It is essential that all parties must know and trust their respective legal and financial advisors.

To begin, after reviewing the facts the respective boards must decide whether there is financial justification and proper fit between the groups. Generally, a non-disclosure agreement is signed to start the proceedings. In large mergers, an anti-trust opinion may be necessary. Due diligence is then conducted regarding the detailed financial and legal information available. Once this phase is completed, the nuts and bolts are typically thrashed out. This includes the board composition, governance, committees, operations, retirement plans, non-compete clauses, and employment contracts. The final steps involve discussion and implementation of operations and infrastructure.

In addition to these key steps, be sure to keep in mind that every merger/acquisition has unique issues, such as pre-
existing real estate ownership, corporate debts and assets, the employment of duplicate managers, etc.

Insist on Accurate Valuation of the Practice

Whether a practice is selling or merging with another party, in order to provide both parties an accurate value of its worth, valuation is necessary. Essentially, the basis of valuation is determining the potential future income stream generated by the practice. Generally, hard assets, with the exception of out-patient centers, are less substantial. Professional appraisers are recommended. Ledger expenses must be carefully reviewed for items such as personal expenses hidden under travel or professional expense categories, which could become problematic issues in the future. Additionally, debt accumulated by either party has to be addressed before merging. If part, or all of one group, owns a medical building, a buy-in plan also must be executed.

Act Wisely, Do Not Panic

When everyone around you is changing lanes, it may seem hard, especially for a solo or small group, not to panic and consider merging with another group or selling to a hospital. Your due diligence will be rewarded when you find the most suitable partner that fits your goals. Examine every detail and try to project out at least ten years into the future about the direction of vascular surgery and your own needs. A prospective partner must have a solid credit record and be financially stable. In addition to financial stability, a prospective partner’s culture and working habits must match your work environment. If a prospective partner’s vision does not match yours, the financial numbers will not be enough to ensure a successful merger.

Who Is In Charge?

There must be complete agreement from both parties on which physician (and manager) will be in charge of the new entity. Specific terms must be outlined. Previous unsuccessful practice mergers have shown that leaving one physician at each physical location can be a fatal mistake. Physician leaders should seek the help of other associates but ultimately they will be in charge of making the major decisions that are approved by the joint board. A physician leader must possess business savvy. If the designated physician doesn’t have business experience and there is time, the physician should be given adequate time and resources to acquire the necessary business acumen. Managers should be in charge of each separate location but report to the business manager. These operational issues are minimized if there is one common location.

It is essential that a merger committee be created to deal with and address issues such as governance, culture, compensation systems, call, office personnel, physician management roles, practice name, etc.

Everything Is on the Table

It has been said, “start at the ending, it's the best place to begin.” At this stage, it would be very wise to list all the individuals, organizations, and institutions that have inherently been considered exempt from criticism or questioning and decide early on which ones possibly could be eliminated. Lifestyle issues, such as call responsibilities and cross coverage, usually are at the top of the list and should be dealt with early on in the conversation. Favorite employees of each respective party also should be addressed. It is not unheard of to experience lobbying and occasionally even
more calculating measures by employees seeking to retain their employment.

Proceed Cautiously When Merging with Other Specialties

The Federal Trade Commission (FTC) has been active lately investigating possible anti-trust behavior by physician groups, as well as hospitals acquiring groups. Although FTC notification is required only if merger activity exceeds $60 million, smaller but illegal merger activity can result in heavy fines and penalties. If there is any doubt, especially in very large mergers, that a proposed merger may result in a dominant vascular surgery group in a small city, an advisory opinion can be obtained from the FTC.

It is important to keep in mind that due to mergers, twenty years of referral patterns could change overnight, depending on the type of specialties within a multi-specialty group.

“Mind the Gap”

“Mind the Gap” is a phrase heard incessantly while traveling ‘The Tube’ in London, but it also can be applied to the inherent inconsistency when using the term "partner," especially when the same remuneration formula is not used across the board. This can lead to disharmony. For example, members that are unable to participate in "bricks and mortar" imaging centers can experience a sizable differential not only in yearly income, but also in investment growth over the years. Another example is if one of the merging groups has a senior member(s) who is taking less call but derives equal compensation. This can lead to hard feelings and resentment among colleagues.

Budget

Budgets may seem geeky and incomprehensible to most physicians but they are vital to set targets and track financial progress. Revenues (and budgets) rest almost entirely on volume projections. Faulty and often too rosy volume projections will cause the group to become more than friendly with the local bank to tap a line of credit to make payroll. No physician wants to see a reduction in their monthly paycheck from something that was considered a “sure” thing. Careful scrutiny of the budget should be adhered to when determining if your revenue projections are reasonable in light of reimbursement cutbacks.

Overhead, Overhead, Overhead

As a result of merger, additional overhead (facilities or human capital related) may be more than enough to drown out any supplementary revenue expected from increased efficiencies or referrals. Furthermore, since staff salaries and benefits are typically the primary expense item, a physician administrator must be vigilant to avoid salary creep. Duplication of technology and/or electronic medical records also must be eliminated.
All Practices Aren't Equal

When practices merge it is important to remember that all practices are not equal. In other words, if the practices entering into the merger have unequal assets, a plan must be developed on how the inequity will be handled. Practices entering into a merger with substantially equal assets tend to be less problematic.

Develop an Exit Plan

A buy-sell agreement should be in place after the merger is completed. If the partners of a merged group have a buy-sell agreement, a future valuation procedure must be spelled out. Will it be fair market value, book value, or some other parameter? Similarly, a stock purchase agreement (or operating agreement if it is a limited liability corporation) also may be part of the merger legal paperwork. This agreement specifies the terms of payment and purchase price for the remaining shareholders to buy back a departing physician’s stock.

If there is a non-compete provision in the employment contract, consideration should be given to the feasibility of one group being able to repurchase their practice assets using the same terms and valuation process as the merger.

Conclusion

As the medical community continues to struggle with determining which providers are best suited to manage particular problems versus who can perform specific procedures with the bare minimum of qualifications, additional mergers and specialty integration are expected in the future. Mergers will continue to be viable options for those in vascular surgery and other related specialties caring for similar patients. With the exception of hospital employment, mergers may be the only available option to weather future regulatory and mandate burdens. No matter the path a vascular surgeon takes as a new graduate or later in their future professional career, being mindful of the key points made in this brief review should prove useful.

This practice memo is not intended to provide legal advice and should not be construed as legal advice or legal opinion. If you are contemplating a practice merger, you should consult a lawyer concerning your specific situation or legal questions.

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