Medical Practice Sales and Acquisitions: 10 Lessons Learned

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In the ongoing quest to achieve efficiencies and lower costs, consolidation continues to take place at every level throughout the healthcare industry — payers, hospitals and physicians alike. In 2012, our large, multi-specialty physician group decided to explore selling our practice for six primary reasons:

1. **We wanted to access additional working capital.** For several years leading up to 2012, we had to have "capital calls" to fund electronic health records, IT equipment and telephone equipment along with other expenses.
2. **We saw the need to expand to new locations, open new medical offices and hire additional physicians.** This required new leases and funding new physicians until they reached "break even."
3. **We saw the need to begin "population health" or care coordination strategies to help our physicians manage the care of increasingly complex and sick patients.** This was driven by new payer contracts that paid incentives for quality and cost of care.
4. **We saw a future where contracting required the physician group to join an accountable care organization (ACO).**
5. **We wanted to avoid Medicare reimbursement reductions and as a result, knew we needed to join a Medicare ACO that could assume a greater financial risk.**
6. **We saw the Orlando market developing "narrow networks," and we needed greater medical alignment with a hospital and key specialists.**

To protect our culture and desire to maintain some independence, we chose to narrow our investigation to hospitals and began acquisition discussions with the two large hospital systems in our market. At the time, our group had 100 physicians and 300,000 unique patients. We were profitable each year and owned six medical offices and one administrative building. We eventually closed a deal with one of the hospital systems on December 31, 2012, nearly a year after we initiated the process. Here are 10 lessons we learned from this experience:

#1 What you think a practice is worth may differ from outside valuation.

By law, non-profit hospitals or organizations acquiring a physician practice can only pay “fair market value” for the practice. This is determined by fair market value of equipment and real estate/buildings — both determined by an appraisal — as well as a value attributed to an assembled work force, which is determined by a valuation firm.

To arrive at a “fair market value,” the hospital hires an outside valuation firm. However, if a practice is even contemplating a sale, it should also hire its own valuator. This allows the practice to have an idea of its worth to better compare and negotiate offers. The cost for this valuation could be a flat fee or a percentage of the purchase price, and the percentage depends on the scope or work the valuation firm will perform. For example, helping to negotiate the final price increases the percentage.

The valuation process can be long and time consuming, and requires a lot of information, including but not limited to the following:

- Five years of financials
- Cash flow statements
- Copies of all contracts (payer and office)
- Accounts receivable history
- Employment history of physicians and employees
- Malpractice insurance
- Any outstanding litigations

In most physician practices, all profits are distributed back to the owners. However, if annum profits exist year after year, and it is expected after the acquisition, these profits will still exist. In this case, these earnings calculated with a multiplier can be paid as a part of the acquisition price.

If you are selling to a for-profit entity, the acquisition price is based on a negotiated price often determined by other acquisitions.

#2 Not everyone on either side is going to like this.
When selling a practice, the current partners may have different expectations from the sale. Older partners and younger partners, in particular, have different needs and concerns. It is important to keep communication open and reach consensus on critical issues early on and throughout the process. Nurturing these relationships helps build trust.

In addition, partners should try to keep their eyes on the end strategy — life after the practice is sold. Key elements to consider include:

- Acquisition agreement
- New employment contract
- New physician compensation agreement (multiple years)
- Governance of the practice
- If separation occurs:
    - Re-payment of a partial percentage of the buy-out proceeds
    - Non-compete provision
    - If real estate is involved, negotiating a long-term lease is important.
- Negotiating the new name of the practice

In addition to your physician team, you also need to involve your staff early on in the process and keep open lines of communication to prevent the rumor mill from running rampant which can poison any practice. As with any big change, staff may tend to think the worst, including losing their jobs. Consolidation is most likely to occur with billing and collections, IT, human resources, and finance and accounting. Clinical staff should be fine as long as they meet the requirements of the new owner.

#3 Money isn't everything. Values, culture, mission and vision are important.
For physicians in particular, love and care of their patients is critical. During the negotiations, discussions need to be established on how the practice will run post-acquisition.

- Who has the authority to hire and fire?
- Who determines and controls the physician's scheduling template?
- Who determines the operating hours of the practice?
- Who determines if patients who have outstanding payment balances will be seen?
- Who determines how the office will function -- from patient check-in to patient check-out?
- What are the rules for closing a physician's panel to patients?

After an acquisition, some physicians tend to forget they sold their practice and find it difficult to give up control and decision-making. The more you can negotiate and address these practice parameters ahead of time, the fewer surprises physicians will experience after the deal is complete.

#4 Be careful what you ask for — you just might get it. It may be great short term, but you pay a price later.
It is important to know why you are selling your practice. Are you looking for contracting leverage or higher reimbursement? Do you need access to working capital for things like electronic medical records or expansion? Do you seek access to new contracts through an ACO or narrow network? Are you looking to sell real estate or lease a building?

When selling your practice, you give up some independence and decision making. During the negotiations, try to discuss changes that will occur after the acquisition:

- Contracting – Will you have to accept new patients from new payers like Medicaid, Advantage Medicare or ACOs?
- Metrics — Will quality metrics be imposed on the physicians?
- Practice Structure — Will the practice hours change?
- Coverage — Know how “call” coverage will work.

It is critical to understand what the acquiring entity is looking for as well as their mission, culture and strategic plan to see if it is the right fit. Early in the process, get names and contact information from others who have joined the acquiring entity. Ask them questions:

- What did they like?
- Where were the sticking points?
- Are they happy as employees of the new entity?
- How did the staff fare?
- What didn’t work?

The values of the two organizations must match. Expectations, on both sides, need to be discussed and agreed upon.

That said, keep in mind that healthcare in its present form is unstable. Total healthcare spending continues to increase and will only get worse with the aging of the Baby Boomers. The goal will be to make medicine available to more people and at an affordable cost. Regardless of a merger or acquisition, everyone must expect changes in the delivery of healthcare, including the following:

- Moving away from “fee for service”

- Moving toward "fee for quality" and full risk
- Payers developing "narrow networks" based on quality scores and total patient cost of care
- Practices required to provide care coordination services to very sick patients
- Physicians incentivized on closing medical care gaps

Finally, and perhaps most importantly, **make sure anything important is put in writing**.

#5 Due diligence on both sides means more than just looking at finances.
The due diligence process is a lengthy one, taking six months to a year. However, it provides an opportunity for reflection and deep analysis of your own practice and the potential acquiring entity. You will both take on a discovery process that allows you to learn about each other and encompasses key information on the nature of each practice and its performance. This will include an extensive list of company data, financials, technology, assets inventory and staffing.

There are also agreement considerations to evaluate. Are you interested in a physician partnership or a physician employment agreement? Is there also an interest to acquire the practice assets and property? These two things are not mutually inclusive.

From the acquiring entity's perspective, they want to ensure that practices acquired bring strength to their organization. They want the physicians and team members to fit into their culture and to know that the assets brought with the acquisition are sound and do not financially drain the organization. They also want to ensure that the acquired practice is financially healthy prior to the acquisition and does not come into the company with any legal or compliance issues.

#6 Really evaluate what you want long term and focus on getting that during negotiations.

In negotiating a physician new employment contract, you want to protect physician compensation from being decreased. Keep in mind higher hospital expense allocations, especially IT, billing and collections. Try negotiating a collections guarantee on expected revenue as well as performance incentives such as quality, cost of care and patient satisfaction. Also, negotiate guaranteed salaries at the transition due to collection delays from changing the tax ID number. This protection should be in a long-term contract.

#7 Start "living together" as soon as possible.
It is crucial to form relationships and develop mutual respect across both organizations. Trust comes from getting to know one another and maintaining ongoing communication of expectations and concerns.

Determine ahead of time how you would handle a sudden major disagreement. Effective communication is critical. Listen to the buyer's side and concerns, and understand where they are coming from. Communicate why something is a concern for you as the seller. Negotiations are an attempt to meet in the middle unless compliance/law dictates otherwise. Consider bringing in others who can support your concerns and help to provide new ideas to be considered by both parties.

#8 Remember that compromise takes both sides giving up something. This is as important after the acquisition as it is during negotiations.
With the rapid changes occurring in medicine, it is undeniable that a surprise is going to arise. Both the buyer and the seller should have a person responsible for successful negotiation. These two persons should continue to meet periodically after the transactions have been completed, and they are responsible for working together to solve problems that arise after the transaction. This is where good relationships, trust, transparency, and genuine concern for achieving a "win-win" are critical.

#9 It is very difficult for those who have been owners and in charge to suddenly become employees.

In any form of merger or acquisition, physicians will give up some degree of decision-making, and this is hard. Be prepared to hear the following:

- "What you're proposing is unacceptable; I'm the physician."
- "This is my practice, and I decide how things are to be done."
- "This is how we've always done things around here…"

During negotiations, things that are important to the doctors should be laid aside and negotiated separately to minimize any surprises later. Again, anything agreed upon must be in writing and not simply sealed with a handshake. Key items to consider include:

- How physician compensation will be calculated and for how long. Exact methodologies must be documented and agreed upon.
- Practice governance
- Treatment and retention of employees
- Bonuses and calculations
- Contracts, payers, treatment of risk contracts, capitation agreements, acceptance of Medicare and Medicaid
- Malpractice limits
- How new physicians will be hired
- Expense allocations of practice expenses to physicians
- Billing and collection costs to be passed on to the physicians (make sure there is a good history of the buyer's ability to bill and collect)
- IT expenses to be pushed down to the physicians
- Care coordination expenses

Know the critical things you want in the practice, discuss them, agree upon them in writing, and include them as part of the acquisition agreement.

#10 Charts (patients) are not necessarily an asset that has monetary value.
Old paper charts have little to no value (maybe $10 to $25/chart). Electronic patient charts have more value, and this varies widely (estimated value $100 to $135/chart). The more patients you have, the more negotiating room you have in an acquisition.

Closing Thoughts
Selling a practice is a bit like running a marathon. It takes preparation, commitment, hard work, persistence and endurance to cross the finish line in winning form. It also helps to have a “team” supporting you throughout the journey. The two most important resources you need on your side every step of the way are a skilled negotiator and a lawyer with experience in this arena.

I also recommend pursuing a sale with two different organizations at the same time as it provides you with leverage. Fair market value is recognized if another company offers a higher acquisition price. If this strategy is pursued, make sure it is spelled out in the non-disclosure agreement.

And finally, no transition is successful without strong communication throughout the entire process — with your physicians, your staff and your patients. Share your “why” for the merger, prepare them for the new path forward and keep them well informed along the way.