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Is a Practice Merger in Your Future?

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What an orthopaedic practice should consider

Statistics show dramatic trends in the acquisition of medical practices by hospitals, the creation of large practice organizations, and the disappearance of the individual practitioner. For example, in 2014, only 35 percent of physicians described themselves as independent practice owners, according to a study by the Physicians Foundation. Just 6 years earlier, 62 percent of physicians identified themselves as independent practice owners. That same study found that 53 percent of respondents describe themselves as employees of a hospital or medical group, up from 38 percent in 2008.

Although maintaining an independent solo physician practice is challenging, remaining private can be a viable option for some orthopaedic groups. In fact, while orthopaedic surgeons are less likely to be in solo practice then other physicians, they are also less likely to be employed by a hospital or group. According to the most recent AAOS member survey, 35 percent of respondents were in an orthopaedic group setting, compared to 15 percent in a private practice solo setting, and 15 percent in the hospital/medical center setting.

Many private orthopaedic practices have grown through the consolidation of several regional practices. For example, Resurgens Orthopaedics of Atlanta includes approximately 85 orthopaedic surgeons and numerous affiliated professionals practicing in 21 clinics. Similarly, OrthoCarolina, based in Charlotte, N.C., is home to more than 120 physicians. Both groups have grown in a variety of ways, from traditional hiring of fellowship physicians to merging smaller practices into the large groups.

Assessing the practice's options

Deciding whether to stay a small independent group is difficult. Weighing the pros and cons can help groups match their desires and abilities in making the decision.

Consolidation may be the most viable option, for example, if the practice needs access to capital to grow needed infrastructure (such as an electronic health records [EHR] system). Without a sophisticated EHR, practices will not be able to fully participate in pay-for-performance programs.

Mergers may also increase market share and physician pay. Both of these are crucial to recruiting and retaining quality physicians and physician extenders. With more physicians and physician extenders, the practice may also be able to provide full call coverage.

The larger revenue stream resulting from consolidation can generate additional flexibility to increase the number of specialties and ancillary services offered by the practice, which, in turn, enhances revenue. Finally, a larger group will have greater contracting power and negotiating leverage with payers and vendors.

On the other hand, consolidation may result in a very different practice culture, leading to discontent among physicians. For example, as a group grows, it becomes less flexible operationally with a larger bureaucracy and stricter policies that must be followed by all. In addition, clinical operations

become more standardized, with less flexibility for each individual physician to make clinical decisions outside the standard practices the group creates. It may be difficult for experienced physicians to adjust to these new practices. Finally, each practice must determine whether the new model will be sustainable over the long term.

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Selecting an acquisition model

The next step should be to analyze the possible acquisition models (as compared with growth in a truly private practice model). Under one model, the hospital acquires the practice; an alternative is to use a physician practice management (PPM) company as the practice acquirer and employer.

In recent years, a positive shift in philosophy and general physician psychology about hospital employment has occurred. Hospital acquisition and employment of practice physicians offer the following benefits and drawbacks:

- access to referral networks
- access to payer networks
- potentially less flexibility and freedom in day-to-day clinical and operational actions
- potentially additional security with respect to base salary and longevity of employment situation but less upside potential

A different set of considerations applies when considering a PPM model, including the following benefits and challenges:

- potentially high front-end purchase price; especially if the practice is a new platform for the acquirer
- typically fewer local referral sources and less purchasing and payer contracting power
- potentially more flexibility in day-to-day operations and clinical decisions because clinical leadership will likely remain in place
- opportunities for expansion and leadership in PPM company and practice

Next steps

Once a practice has decided to merge or otherwise consolidate with another practice, the two (or more) practices should discuss the following issues:

***Governance*—**How will the new practice be governed? Will there be a board and executive management made up of members from both practices? What powers will the board have? What powers, if any, will be reserved to the owners?

***Compensation*—**How will physicians be paid? Will each receive a base salary plus a bonus? Will all compensation be equal for each owner or will it depend on the physician's contribution to the amount of total revenue generated? How will revenues from ancillary services be shared? How will non-owner physician employees be paid?

***Employment and termination*—**This applies especially to the physician shareholders. How will owner employment agreements be drafted? What are the basic employment terms for each owner? How will the buy-in and redemption pricing for practice ownership be determined? How can a physician quit the new practice or the new practice terminate an owner?

***Allocation of pre-merger liabilities*—**What liabilities from the existing practices will be assumed by the new practice?

***Office locations and staffing*—**Which offices will continue or close? Which staff members will be retained or terminated?

***Practice noncompete*—**Will there be a noncompete clause in termination agreements? If so, what will be its scope and duration?

***Unwinding the consolidation*—**Will some subset of physicians have the ability to unwind the new practice and go back to their old practice structure? If so, how long will this right last?

***Name and branding*—**What will the new practice be called? Many practices use their affiliations with sports teams in their branding, because they believe that the affiliations demonstrate to patients the high esteem in which they are held by the most discriminating of patients.

***Practice culture*—**How do the physicians currently practice? Are the two groups compatible or is one group willing to conform to the other group's practice methods?

***EHR systems*—**If the practices have different EHR systems, how will they be combined? This is very technical and can be costly, so experts should be consulted early.

***Outside joint ventures*—**Does either practice or its physicians participate in an ambulatory surgery center or similar surgical business? If so, what restrictions will be placed on the physicians who are not part of these ventures? What opportunities will there be for the other physicians to invest? If physicians from both practices have investments, how will the merger affect any competing ancillary businesses?

DME and imaging: Practices vary greatly in how they allocate profits from durable medical equipment (DME) and imaging, and strict rules govern these ancillary services. Additionally, these ancillary services provide a significant source of additional income for many orthopaedic physicians.

Thus a comparison of the practices' compensation methods should include close consideration of these ancillary lines.

Steps in consolidation

Successfully effectuating a consolidation involves many steps, ranging from the initial analysis to establishing a smooth transition. In general, the first step is, as described above, determining whether to stay private or consolidate—and identifying other practices for consolidation.

The next step is to assess how the practices fit. This covers discussions with the target practices regarding culture, basic financial aspects, noncompete restrictions, and the other issues mentioned in this article. It also involves an accounting analysis of each practice to make sure each is financially secure.

At this point, practices will generally sign a letter of intent, a nonbinding agreement that covers the following:

- key consolidation plan and timetable
- agreements on key terms
- an exclusivity period during which neither practice will discuss a sale or consolidation with any other party
- a commitment to expend funds to further investigate and negotiate consolidation documents

Diligence and documentation is next, so that each practice knows what it is getting and must do. This stage includes billing and coding audits, benefit comparisons and decisions on continuing or terminating current benefits, and determination of a powerful brand name and logo.

Document negotiations must cover the merger/consolidation agreement, operating/shareholders agreement, form of owner physician employment agreement, form of owner non-physician employment agreement, and third-party negotiations with landlords, lenders, and vendors (among others). Third-party relationships must either transfer to the new practice or be appropriately terminated.

Valuable sports team affiliations should also be carefully examined to ensure that such relationships can continue after the consolidation. Finally, physicians must get credentialed with payers and hospitals in their capacity as owners/employers of the new practice.

At this point, the new practice must have an agreed-upon effective date and start. Beyond that, transition issues must be addressed to ensure a smooth transition for both physicians and patients.

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